

FEDERAL TAX TREATMENT OF LOW INCOME PERSONS

HEARING BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF THE COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES NINETY-EIGHTH CONGRESS

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FEDERAL TAX TREATMENT OF LOW-INCOME PERSONS

THURSDAY, APRIL 12, 1984

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The subcommittee met at 9:30 a.m., pursuant to notice, in room B-318, Rayburn House Office Building, Hon. Charles B. Rangel (chairman of the subcommittee) presiding.

[The press release announcing the hearing and Chairman Rangel's opening statement follow:]

[Press release of Friday, Mar. 30, 1984]

HON. CHARLES B. RANGEL (D., N.Y.), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, HOUSE OF REPRESENTATIVES, ANNOUNCES HEARING TO EXAMINE THE FEDERAL TAX TREATMENT OF LOW-INCOME PERSONS

The Honorable Charles B. Rangel (D., N.Y.), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will conduct a hearing to examine the Federal tax treatment of low-income taxpayers and the poor. The hearing is a continuation of the Subcommittee's review of policy questions related to the recent increase in the poverty rate to 15 percent. The hearing will be held on Thursday, April 12, 1984, in Room B-318 Rayburn House Office Building, and will begin at 9:30 a.m. Testimony will be received from the Administration, the U.S. Census Bureau, and other invited witnesses.

Background

During the last 20 years, the Congress has enacted tax legislation designed to insure that the tax burden on low-income persons would not increase and to maintain the income level at which persons begin to pay income tax (the so-called tax entry point) above the poverty level. In general, three provisions of the Internal Revenue Code—the personal exemption, the zero-bracket amount, and the earned income tax credit—have been used to achieve this goal. In the recent past, adjustments for inflation have not been made to these provisions and, as a result, the tax entry point has fallen below the poverty line.

The Subcommittee's hearing will focus on several overall issues:

- (1) the extent to which persons with incomes at or below the poverty line pay taxes generally and as a percentage of income;
- (2) the extent to which taxes on low-income individuals have changed from the late 1970s to 1984 and how the tax burden will change in the future under current tax policy;
- (3) the present tax entry points in relation to the current poverty thresholds;
- (4) the extent to which persons with incomes below the poverty level rely on earnings (rather than transfer payments) and the impact of the present tax system on such individuals;
- (5) actual amounts of taxes paid by low-income taxpayers, and other categories of taxpayers, including analysis of such taxes as a percentage of income;

- (6) the effectiveness of the personal exemption, the zero-bracket amount, the earned income tax credit or other provisions of the Internal Revenue Code, in alleviating the tax burden of low-income taxpayers and options for change; and
- (7) the extent to which poverty rates and the number of individuals living below poverty would increase if after tax income was compared to the poverty threshold.

Written comments

For those who wish to file a written statement for the printed record of the hearings, *six copies* are required and may be submitted by the close of business Friday, April 27, 1984, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515. An additional supply of statements for the printed record may be furnished for distribution to the press and public if supplies to the Committee office before the hearing begins.

OPENING STATEMENT OF HON. CHARLES B. RANGEL, CHAIRMAN OF THE SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS

This morning the Subcommittee on Oversight will examine the Federal Tax treatment of low-income taxpayers and the poor. Our hearing is a continuation of the subcommittee's review of policy questions related to the recent increase in the poverty rate to 15 percent.

Through the 1970s Congress attempted, in several tax reduction bills, to eliminate the tax burden on families whose incomes were below the poverty line. The legislative history of tax reduction bills enacted in this period indicates a desire to increase the level of income at which a family begins to pay Federal income tax above the poverty level. These levels are called "tax entry" points or "tax thresholds". In general, three provisions of the Internal Revenue Code—the personal exemption, the zero-bracket amount, and the earned income tax credit (EITC)—have been used to achieve this goal.

In 1960, the tax entry point for low-income families was 10.3 percent below the poverty line. Tax cuts in 1964 significantly reduced this gap, and legislation enacted in 1969, 1971, and 1975 succeeded in eliminating the gap. For example, the earned income tax credit, enacted in 1975, was designed not only to remove poor people from the income tax rolls but also, through its refundable nature, to offset some of the impact of payroll taxes on their earnings.

In 1981, Congress enacted the President's spending cuts and tax reduction program. On the tax side, the President's program included across-the-board cuts in tax rates, indexing, and a whole host of business tax cut provisions. Tragically, the President's program did not contain adjustments to the major tax law provisions that would most help the poor. As a result, tax thresholds for the poor have again fallen below the poverty line.

In 1984, the projected poverty level for a four-person family will be approximately \$10,600, but a person will begin paying taxes at \$8,783. Thus, percentage gap between the tax entry point and the poverty level for this family will be 17.2 percent. In 1985 and 1986 the gap will increase to 19.5 percent and 21.5 percent, respectively—the largest gap since before 1959. It is important to emphasize that this trend will continue for some families even after indexing since the earned income tax credit is not indexed.

For a family of four with earnings equal to poverty, combined Federal income and payroll taxes have increased from \$269 in 1978 to \$1,076 in 1984, an increase of \$807. This represents an increase in tax from 4 percent to 10.1 percent of income. In contrast, for families with income substantially above the poverty rate, tax burdens have declined as a percentage of income.

Poverty level workers also are hit by State and local income taxes, regressive sales taxes, and other taxes based on earnings. Moreover, the poor and poverty level workers have suffered from administration cuts in public assistance programs that often supplemented meager incomes. The Congressional Budget Office, for example, analyzing the cumulative effect of budget and tax changes enacted since 1981 found that low-income families and the poor have lost the most money and high-income families have gained the most.

To address the alarming upward trend in poverty rates and the basic unfairness of the administration's treatment of taxes and programs for the poor, I have introduced H.R. 4920, the Omnibus Anti-Poverty Act of 1984. In part the bill reduces Federal taxes for the working poor by substantially increasing the earned income

tax credit. I would hope that the administration will actively support efforts to increase the EITC.

The ranks of the poor are growing in America as is the pain of their suffering. A significant part of their burden is increasing taxation. Taxing the poor sounds like a throw back to the dark ages. No modern income tax ought to tax the income of those who have so little as to be designated poor. Tragically, our tax system does so. I realize our problem with the deficit. But, I believe we must take action to relieve tax burdens on poverty level wage earners.

Chairman RANGEL. The Oversight Subcommittee will be opening up hearings on the question of the impact of Federal tax policies on low-income families and individuals and the poor. We are glad to have Frank Guarini here and I hope he will make an opening statement.

I want to thank the administration and other Government agencies for agreeing to participate, and to clarify the direction in which this administration is going. While there is a lot of emphasis on the part of the Congress to reduce the deficit, we want to make certain that whatever policy we shape in the Congress with the executive branch improves the treatment of poor and low-income people.

It is rather dramatic that yesterday the House of Representatives passed a bipartisan bill. We expect the Senate to be doing the same thing and in May we should be going into conference. This is the first time with this administration that the legislative branch and the executive branch have worked together toward the same goal on tax policy.

What we do not know is the severity of the impact that current policies have had on the low income and the poor, and what we are committed to do is to make certain that the Ways and Means Committee, hopefully with the executive branch and the Senate, can correct what I would like to believe are oversights.

Today, we will examine the Federal tax treatment of low-income taxpayers and the poor. This will be a part of our continuing review of the questions relating to the fact that there has been a sharp increase in the poverty rate, no matter which formulas are used to determine poverty.

Through the 1970's, in several tax reduction bills we tried to eliminate the tax burden on families whose incomes were below the poverty line. The record would indicate that we had a desire to make certain that the very poor paid little or no tax.

The levels at which payments begin, are called tax entry points or tax thresholds. Three provisions of the IRS Code—the personal exemption, the zero bracket amount, and the earned income tax credit—primarily determine the tax entry point. In the past we have tried to use combinations of these to relieve the burden on the poor.

In 1960, the tax entry point for low-income families was 10.3 percent below the poverty line. Tax cuts in 1964 reduced the gap, and legislation enacted in 1969, 1971, and 1975 have eliminated the gap. For example, the earned income tax credit which was enacted in 1975 was designed not only to remove poor people from the income tax rolls, but through its refundable nature to offset some of the impact of payroll taxes on their earnings.

In 1981, Congress enacted the President's spending cuts and tax reduction program. On the tax side, the President's program in-

cluded across-the-board cuts in tax rates, indexing, and a host of business tax cut provisions. Tragically, the President's program did not contain any adjustments for the major tax law provisions that would help the poor. As a result, the tax thresholds for the poor have again fallen below the poverty line.

In 1984 the projected poverty level for a four-person family will be approximately \$10,600, but a person will begin paying taxes at \$8,783. Thus, the percentage gap between the tax entry point and the poverty level for the family will be 17.2 percent. In 1985 and 1986, the gap will increase to 19.5 percent and to 21.5 percent, respectively, the largest gap since before 1959.

It is important to emphasize that this trend will continue for some families even after indexing, since the earned income tax credit, which we have locked into place and certainly hope to expand in conference, is not indexed. For a family of four with earnings equal to poverty, combined Federal income and payroll taxes have increased from \$269 in 1978 to \$1,076 in 1984, an increase of \$807. This represents an increase in tax from 4 percent to 10.1 percent of income.

In contrast, for families with incomes substantially above the poverty level, tax burdens have declined as a percentage of income.

Poverty-level workers are hit hard by State and local income taxes, regressive sales taxes, and other taxes based on earnings. Both the Senate and the House increase excise taxes, which again impact most severely on the low-income groups.

The Congressional Budget Office, in analyzing the cumulative effect of budget and tax changes enacted since 1981, found that low-income families and the poor have lost the most money, and high-income families have gained the most money.

To address the alarming upward trend in poverty rates and the basic unfairness of the administration's treatment of taxes and programs for the poor, I have introduced, with a number of cosponsors from the House Ways and Means Committee, H.R. 4920, the Omnibus Anti-Poverty Act of 1984. In part, the bill reduces Federal taxes for the working poor by substantially increasing the earned income tax credit, therefore attempting to close the gap between the poverty level and the tax entry points.

I would hope that the administration would see its way clear to actively support this and other efforts that would increase the tax entry level and certainly support the expansion of the EITC. As the ranks of the poor are growing in America, part of this burden is due to tax policy and to budget policies which have reduced many services for the poor. We all can agree that, as the administration and the Congress attempt to work out reconciliation in the budget and tax policy, and while the emphasis has to be on the reduction of the deficit, we cannot forget that the poor are affected adversely by both the spending reduction as well as the revenue increases, and they have not been protected in the last few years.

Mr. Guarini.

Mr. GUARINI. Thank you, Mr. Chairman.

Mr. Chairman, I think these hearings are very timely. I understand that in the last 3 years there have been four million people who slipped under the poverty line, and that we have had a situation in our country where the tax laws have changed very quickly

in the last 5 years. Some people feel they could hardly keep up with the changes that we have had in the tax laws.

We have shifted the tax burden from different groups, and we have had a situation where there has been a polarization of the wealth in our country. As we say, the rich get richer and the poor get poorer, and that certainly has seemed to be an observation which I have noticed.

Corporations, of course, have a lower responsibility. They have gone from 20 percent to 8 percent of our tax revenues, and when we look at the overall picture there is a sense that the poor and less fortunate are not being wisely considered in our tax laws.

There are regressive taxes such as excise taxes, and they have grown considerably in the recent years. And I think that it is very, very fitting that we examine this issue at this time.

I think that the reason that we are very concerned also is that in our country only 54 percent of the people vote in our presidential election, and I think that there is a sense in our country that everyone has not participated with the level of dignity that they should. And our tax laws go to the basis of the economics of all of the people of our country.

So we have a situation out there that I think is worsening, and that this is very, very important, that we have a full view and oversight into our tax laws as to how they effect this particular group of people.

Thank you.

Chairman RANGEL. And I think it is safe to say, Mr. Guarini, that as the tax-writing committee has to make a series of complex decisions affecting tax policy, the group that we are talking about today for a variety of cultural and economic reasons, is not able to share or transfer the impact of these decisions on their lives, and also are not able to lobby on their behalf, in the best sense of the word "lobby."

And so this is an initiative that our Oversight Subcommittee has taken, and we hope that the administration accepts that in the spirit in which we are holding these hearings.

We are pleased to have Mr. Matsui take time to sit on this panel. He is a member of the full committee and not on the Oversight Subcommittee, but certainly has always exercised this type of oversight concern for the poor of this country. And I think, with all of the lack of popularity that the poor are enjoying during this period, that your presence is more than needed, and we thank you for joining with us.

Would you care to make an opening statement?

Mr. MATSUI. Well, Mr. Chairman, I would just like to thank you and Mr. Guarini and others on the subcommittee for inviting me here today.

As the chairman knows, last year the Public Assistance and Unemployment Subcommittee in conjunction with your Oversight Subcommittee held hearings on the whole issue of poverty. I thought those hearings were very enlightening. I certainly appreciate the opportunity now to revisit aspects of that issue with this subcommittee.

I would only just reiterate what you just said in response to Mr. Guarini, that the poor to a large extent do not have their own con-

stituency. That fact was really borne out by the 1981 tax bill, when the Ways and Means version of the 1981 tax bill proposed to change the earned income credit by increasing the amount from 10 to 11 percent, plus skewing the amount so the phase in occurred at a rather slower rate up to \$10,000.

The administration's version, of course, did not have such a provision, although they had provisions that helped corporations, and basically those in the higher income brackets. So I think your statement is borne out by the facts and we certainly look forward to participating in these hearings with you today.

Chairman RANGEL. I think the administration was very honest with us, though, in that the tax cuts were designed to help those people who were more inclined to invest the savings rather than to spend the money on food, shelter, and clothing. So the purpose was served, even though I do not think we got the results that we all hoped we would get.

Mr. Charles McLure, Jr., Deputy Assistant Secretary for Tax Analysis of the U.S. Department of the Treasury, will be our first witness. Mr. McLure, we have your statement and you may proceed in a fashion which you find most comfortable.

But I do hope, if not in your testimony, then certainly after, that you may be of assistance to us in seeing how we can remedy the situation that poor and low income people find themselves in, whether it is because we increased social security taxes, because the tax entry level has been lowered relative to the poverty line, or because of medicaid and AFDC reductions.

We do not have jurisdiction over all these matters, but if you agree with us that it was not intended that the poor and low income not share in the decrease in tax liabilities on the part of the working population, then we hope that you could come up with some recommendations that the administration can live with, so that we can move swiftly forward and remedy the situation.

And so we thank you for taking time out, and we just want you to know that the spirit of these hearings is not one of confrontation, but one hopefully of cooperation. Thank you.

STATEMENT OF CHARLES E. McLURE, JR., DEPUTY ASSISTANT SECRETARY FOR TAX ANALYSIS, DEPARTMENT OF THE TREASURY

Mr. McLURE. Thank you. Mr. Chairman and members of the subcommittee, I am pleased to be here today to discuss with you some of the issues related to the impact of the tax system on the low-income population.

I want to begin by emphasizing one very basic fact of particular relevance to these hearings that is often overlooked. Inflation is the main reason that many low-income persons have come into the personal income tax rolls since 1978. In the absence of tax indexing or periodic legislative adjustments, the static tax threshold—the income level at which taxes begin to be paid—would inevitably fall behind the poverty level, which, of course, increases with inflation. This fact is a matter of great concern to this administration; just last week President Reagan, speaking before a Catholic parents' as-

sociation in New York, specifically expressed his concern over the failure of the dependency exemption to keep up with inflation.

If prices had continued rising at the rate they were when this administration took office, inflation would have pushed even more low-income households onto the tax rolls.

The administration's tax program has helped protect low income taxpayers from inflation. The indexing provisions that will take effect next year will prevent inflation from levying automatic tax increases on all taxpayers, and indeed on those who would be below the tax threshold in the absence of inflation. Indexing provides a larger proportionate reduction in the tax bills of low-income than of high-income taxpayers.

As you are well aware, the current Federal tax system is coming under increasing criticism as being unfair. Even with indexing in place, guarding the poor against bracket creep, the tax system will still not be fair to the poor or the nonpoor. A concern with tax fairness is one of the primary factors that motivated President Reagan to request that the Treasury Department conduct a major study of fundamental tax reform and report back to him in December.

Our recommendations at that time will address the particular questions of tax equity that are the subject of these hearings, namely the tax treatment of the low-income population. Since our study is still in an early stage, we have not yet determined what those recommendations will be. But I can assure you that among the issues of particular relevance to the low-income population that we are examining are: The appropriate level of the personal and dependent exemptions and the zero bracket amount; the earned-income tax credit and the general treatment of the working poor relative to the nonworking poor; and the taxation of families of various compositions.

An additional major focus of the study is the simplification of the tax system. Simplification is especially important for the low-income population, since the poor are generally least able to cope with the administrative complexities involved in filing and paying their taxes, in filing a return simply to get withheld taxes refunded, in adjusting the number of exemptions so that overwithholding does not occur, or in claiming the earned-income tax credit [EITC].

I will not take the subcommittee's time to read the portion of my prepared statement that provides an overview of sources of Federal revenues and the pattern of taxation borne by the general population. Regarding taxes on the low-income population, I would note two general conclusions:

First, for low-income workers payroll taxes are substantially greater than the personal income tax. A family of four at the poverty level in 1984 would still pay nearly twice as much payroll as income taxes, \$711 versus \$365.

To some extent, it makes sense to view social security taxes differently from income taxes, since social security contributions result in tangible and readily identifiable benefits when the worker retires, becomes disabled or dies. And yet, this way of looking at the question is not totally satisfactory. The fact that the low-income worker will ultimately receive a higher pension based on his or her contributions to social security does not completely offset

the fact that the obligation to pay these taxes currently takes income from families who are poor today.

Second, workers at the poverty level have historically seen their income taxes rise during times of inflation, since the poverty level is adjusted annually for inflation but the income tax threshold is not. Since the 1964 Tax Act, Congress has generally used periodic increases in the zero bracket amount and the personal exemptions to achieve approximate equality between the poverty level and the tax-free amount.

In addition, in 1975 Congress enacted the earned income tax credit to offset some of the burden of payroll taxes on low-income workers with children and to provide work incentives to them. In 1978, Congress raised the income limits under which taxpayers were eligible for the credit to a maximum of \$10,000 of earnings. The Senate Finance Committee has recently recommended increasing the maximum credit to \$525 and the maximum earnings level to \$11,000.

Beginning in 1985, tax indexing will adjust annually the personal exemption and the zero bracket amount, but not the earned-income credit, for increases in the price level. The tax threshold will then be automatically increased and no longer will inflation pull many low-income households into the tax rolls.

The low-income population is composed of many different types of families and individuals in different situations. The tax system is designed to recognize many of the differences, such as number of children, old age, blindness, and marital status. At the same time, the tax system treats differently many people who appear to be similar. For example, it is estimated that in 1981, 10 percent of all households below the poverty line paid some Federal income tax and 44 percent paid payroll taxes. Virtually no household without an earner paid any form of tax, but 20 percent of the households paid Federal income taxes and 90 percent paid payroll taxes.

A better understanding of the tax-paying status of the low-income population can be gained by disaggregating even further to distinguish among families with positive and negative tax liabilities and families headed by elderly and nonelderly persons. Some of the preliminary results of this analysis are presented in tables 6 and 7 of my prepared statement.

First, more poor families have negative income tax liability than pay positive amounts of income tax. This results from the earned income tax credit and, not surprisingly, is mainly applicable to families headed by someone under 65 and only to families with at least one earner.

Some working families slightly above the poverty line also have negative income tax liabilities, but nearly half pay positive amounts of tax. A substantial fraction of families below the poverty line, some 70 percent, have neither positive nor negative income tax.

Second, although poor families without earners are not eligible for the EITC, few of them incur any positive tax liability. This is true, but to a lesser extent, for families just above the poverty line. In both cases, nonelderly families are more likely to owe taxes than the elderly. This shows the effect of the additional exemption for being 65 or older.

Third, when social security taxes are taken into account, the tax burdens on most poor and nonpoor families increase. Hardly any poor or near-poor families with earnings receive net tax refunds, that is, refunds of EITC, in excess of the FICA tax. Only 14 percent of the poor and 3.5 percent of the near-poor do so.

How the tax burden on the low income population has changed in recent years is more difficult to quantify with any confidence, in part because data for 1983 are not yet available. As part of the Treasury's tax reform study, we are preparing a data base for 1983 that should enable us to answer many of these questions.

From one perspective, the relative tax burden on low income households appears to have fallen. Between 1978 and 1982, the share of total Federal personal income tax revenues generated by the lowest quintile of taxpayers fell, from 2.4 percent to 2.1 percent, while the share paid by the top 5 percent of taxpayers rose, from 31.2 percent to 33.1 percent.

These figures do not adequately describe the problem, however, because they deal only with the distribution of tax payments within the tax-paying population. Since the tax threshold has not kept pace with increases in the price level, inflation has brought more tax units with incomes at or below poverty level into the tax system.

I think it is worth noting that the number of low income taxpayers would have increased less if indexing were already in effect. For example, if indexing had begun in 1979, the last time the ZBA and personal exemption were increased, there would have been 5.2 million, or 29 percent, fewer taxpayers with AGI of \$10,000 or less in 1982.

I would now like to make several concluding comments about the taxpaying status of the low income population. First, the social security tax is the largest tax being paid by the low income population. From the perspective of low income workers, it is important that the bipartisan compromise on social security adopted last year kept increases in social security taxes to a minimum and thereby kept this tax burden from rising higher.

Second, repealing indexing would more seriously affect the tax liability of low than of high income people. Repealing indexing would raise the income taxes paid in 1985 by those with incomes of \$10,000 or less by 10 percent. By comparison, for taxpayers with income over \$100,000, taxes would rise by less than 2 percent if indexing were repealed.

Third, the ERTA tax reductions are often criticized as favoring the wealthy because they reduced taxes for high income taxpayers by larger dollar amounts and by larger percentages of income than they did for low income taxpayers. But with a progressive tax system, an equal proportional cut in all rates would inevitably produce this result because under such a system the wealthy pay larger amounts of tax, that represent larger fractions of their incomes.

As a percentage of tax liability, the overall ERTA personal tax cuts were somewhat larger for low income than high income taxpayers. Tax liability under 1984 law for those with income under \$10,000 was reduced by 28 percent, but for taxpayers with incomes over \$200,000 by 19 percent.

Finally, let me repeat that, now that this administration has achieved its first goals of slowing inflation and getting the economy growing again, we are turning our attention to fundamental tax reform. The report that the Treasury Department will submit to the President in December will address the issues of basic fairness that are the subject of these hearings.

Thank you.

[The prepared statement follows:]

STATEMENT OF CHARLES E. MCLURE, JR., DEPUTY ASSISTANT SECRETARY FOR TAX
ANALYSIS, DEPARTMENT OF THE TREASURY

Mr. Chairman and Members of this Subcommittee: I am pleased to be here today to discuss with you some issues related to the impact of the tax system on the low income population.

I want to begin by emphasizing one very basic fact of particular relevance to these hearings that is often overlooked. Inflation is the main reason that many low income persons have come onto the personal income tax rolls since 1978. In the absence of tax indexing or periodic legislative adjustments, the static tax threshold—the income level at which taxes begin to be paid—inevitably falls behind the poverty level, which is adjusted annually to reflect inflation. This fact is a matter of great concern to the Administration; just last week, President Reagan, speaking before a Catholic parents' association in New York, specifically expressed his concern over the failure of the dependency exemption to keep up with inflation. This Administration's economic policies attached top priority to lowering inflation and getting the economy moving again, and they have succeeded on both fronts. If prices had continued rising at the rate they were when this Administration took office, inflation would have pushed even more low income households onto the tax rolls.

The Administration's tax program has helped protect low income taxpayers from inflation. The indexing provisions that take effect next year will prevent inflation from levying automatic tax increases on all taxpayers—and indeed, on those who would be below the tax threshold in the absence of inflation. Indexing provides a larger proportionate reduction in the tax bills of low income than of high income taxpayers.

As you are well aware, the current Federal tax system is coming under increasing criticism as being unfair: unfair in that it treats taxpayers differently who in many important respects are similar, and unfair in that it does not properly distinguish between families and individuals who are really different. Even with indexing in place, guarding the poor against bracket creep, the tax system will still not be fair—to either the poor or nonpoor. A concern with tax fairness is one of the primary factors that motivated President Reagan to request that the Treasury Department conduct a major study of fundamental tax reform and report back to him in December.

Our recommendations at that time will address the particular questions of tax equity that are the subject of these hearings, namely the tax treatment of the low income population. Since our study is still in an early stage, we have not yet determined what those recommendations will be. But I can assure you that among the issues of particular relevance to the low income population that we are examining are: the appropriate level of the personal and dependent exemptions and the zero bracket amount; the earned income tax credit and the general treatment of the working poor relative to the nonworking poor; and the taxation of families of various compositions. An additional major focus of the study is the simplification of the tax system. Simplification is especially important for the low income population, since the poor are generally least able to cope with the administrative complexities involved in filing and paying their taxes, in filing a return simply to get withheld taxes refunded, in adjusting the number of exemptions so that overwithholding does not occur, or in claiming the Earned Income Tax Credit (EITC).

Overview of the Sources of Federal Revenues

Before focusing on the burdens that the Federal income and social insurance taxes impose on the low income population, it is useful to understand how those taxes fit into the overall picture of the Federal government's revenue raising efforts. We estimate that, in 1984, the individual income tax and social insurance taxes will generate nearly 80 percent of the Federal Government's budget receipts, or \$536 billion; 44 percent of the total (or \$295 billion) will come from individual income taxes

and 36 percent (or \$241 billion) from social insurance contributions. The corporate income tax accounts for 10 of the remaining 20 percent of total Federal revenues, custom duties and excise taxes (apart from the windfall profit tax) for another 5½ percent, the windfall profit tax for 1½ percent, and other miscellaneous receipts for the final 3 percent. (See Table 1). As a fraction of GNP, the individual income tax in 1983 represented 8.9 percent, social security receipts 5.8 percent, and all revenues 18.6 percent. (See Table 2).

The most dramatic change in the composition of Federal revenues in the last two decades or so has been the increase in the role of social insurance taxes. In 1960, they accounted for only 16 percent of total Federal revenues. By 1980 that figure had nearly doubled, reaching 31 percent. It has continued to increase through the 1980's, though much more slowly. While the importance of social insurance contributions has been rising, the reliance on the corporate income tax and on excise taxes and customs duties has been declining. The share of Federal revenues coming from the individual income tax has remained comparatively steady, ranging generally between 42 and 48 percent of the total. For the remainder of this decade, we project that under current law the reliance on both the individual income and social insurance taxes will increase slightly. For the issue of the tax treatment of the low income population, this overview of Federal revenues highlights the importance of the separate social security tax system as well as the individual income tax. I will return to this in a moment.

The Tax-Paying Status of the General Population

Both the Subcommittee announcement describing these hearings and the letter from the Chairman to Secretary Regan inviting Treasury's testimony expressed a particular interest in information on the current Federal tax burden on the low income population, as well as on past and prospective trends in that burden. The burden of Federal taxes on the low income population can be viewed from a number of perspectives. Compared to the rest of the population, the low income population is much less likely to pay any taxes and is even likely to receive a refund as a result of the earned income tax credit. (Table 3) And for those low income people who do incur positive income tax liability, taxes represent a much smaller share of AGI than for higher income units. The progressive pattern of taxes—absorption of a larger share of income at higher income levels—would be even more pronounced if transfer payments and in-kind benefits were included in income.

When FICA taxes as well as personal income taxes are considered (Table 4), the picture changes somewhat. Low income tax units become much more likely to have positive tax liability, their average tax liability increases substantially, and they bear a larger share of the total tax burden when social security as well as personal income taxes are considered.

While these hearings are focusing on the taxpaying status of the poor, there is also interest in the taxpaying status of the very rich. Table 5 shows that virtually everyone—99.7 percent—with AGI of \$200,000 or more pays Federal income tax. More precisely, in 1981—the last year for which Treasury's report on High Income Taxpayers is available—only 226 returns in the top AGI class (or 0.4 percent of returns in that bracket) had no income tax liability. If the payment of foreign taxes creditable against U.S. liability is taken into account, the number drops to 79. If we use a better and broader definition of income—expanded income, which takes into account most preference income—there are 304 nontaxable returns if only U.S. tax liability is counted, and 114 if foreign taxes are recognized. Table 5 shows that since the minimum tax was tightened in 1975, very few top bracket returns have totally avoided paying any U.S. tax.

Taxes and the Low Income Population

An alternative approach for viewing the burden of Federal taxes on the low income population is to focus solely on those households. That was the perspective reflected in the "Background Material on Poverty" prepared by the Ways and Means Committee staff and released last October. I will not take the Committee's time to repeat much of that useful information, but I would note two general conclusions.

First, for low income workers payroll taxes are substantially greater than the personal income tax. As the Committee staff noted, a family of four at the poverty level in 1984 would pay nearly twice as much payroll as income tax—\$711 vs. \$365. To some extent it makes sense to view social security taxes differently from income taxes since social security contributions result in tangible and readily identifiable benefits when the worker retires, becomes disabled, or dies. While it is conceptually and practically difficult to match payment of income taxes with receipt of benefits,

with social insurance taxes this is not as difficult. It is clear that low income workers receive a higher return on their contributions to social security than do higher paid workers. And yet, this way of looking at the question is not totally satisfactory. The fact that a low-income worker will ultimately receive a higher pension based on his or her contributions to social security does not completely offset the fact that the obligation to pay these taxes takes income from families who are poor today.

Second, workers at the poverty level have historically seen their income taxes rise during times of inflation, since the poverty level is adjusted annually for inflation but the income tax threshold is not. The tax threshold is often defined as the level of income at which someone first incurs positive tax liability, based on the combined effect of personal and dependent exemptions, the earned income tax credit, and the zero bracket amount (in earlier years called the minimum standard deduction or low income allowance).

Since the 1964 Tax Act, Congress has generally used periodic increases in the zero bracket amount and the personal exemptions to achieve approximate equality between the poverty level and the tax-free amount. Most recently in 1978 the personal exemptions were raised from \$750 to \$1,000 and the zero bracket amount from \$2,200 to \$2,300 for a single or head of household return and from \$3,200 to \$3,400 for a joint return. In addition, in 1975 Congress enacted the Earned Income Tax Credit to offset some of the burden of payroll taxes on low income workers with children and to provide work incentives to them. In 1978 Congress raised the income limits under which taxpayers were eligible for the credit, to a maximum of \$10,000 of earnings. The Senate Finance Committee has recently recommended increasing the maximum credit to \$525 and the maximum earning level to \$11,000.

Beginning in 1985, tax indexing will adjust annually the personal exemption and the zero bracket amount (but not the earned/income credit) for increases in the price level. The tax threshold will then be automatically increased, and no longer will inflation pull many low income households into the tax rolls.

The low income population is composed of many different kinds of families and individuals in different situations. The tax system is designed to recognize many of the differences, such as number of children, old age, blindness, and marital status. At the same time the tax system treats differently many people who appear to be quite similar. For example, the Census Bureau has recently released a report in which it estimated that in 1981, 10 percent of all households below the poverty line paid some Federal income tax and 44 percent paid payroll taxes. When it separates the poverty population into households without any earners and those with earners, it estimates, not surprisingly, that virtually none of those without an earner paid either form of tax, but that 20 percent of the households with earners paid Federal income taxes and 90 percent paid payroll taxes.

Just as these Census figures show the importance of disaggregating the poverty population into households with earners and those without, a better understanding of the taxpaying status of the low income population can be gained by disaggregating even further to distinguish among families with positive and negative tax liabilities, and families headed by elderly or nonelderly persons. We have performed such an analysis using a modified Current Population Survey (CPS) for 1982, and I would like to share with you some of the preliminary results of that analysis, which are presented in Tables 6 and 7.

Before discussing the figures, I would like to point out that they are not strictly comparable to the analysis of after-tax income conducted by the Census Bureau, primarily because our data are adjusted for the underreporting of various types of income and refer to a different year. The figures also differ from the kind that Treasury usually presents (as in Tables 3 and 4) because the income classifier here includes nontaxable transfer incomes, and because the data group people by family unit rather than tax unit.

The tables show several interesting points. First, more poor families have negative income tax liability than pay positive amounts of income tax. (Table 6.) This results from the earned income tax credit, and, not surprisingly, is mainly applicable to families headed by someone under 65, and only to families with at least one earner. Some working families slightly above the poverty line (with income between 100 and 150 percent of the poverty line) also have negative income tax liabilities, but nearly half pay positive amounts of tax. A substantial fraction of families below the poverty line—70 percent—have neither positive or negative income tax.

Second, although poor families without earners are not eligible for the EITC, few of them incur any positive tax liability. This is true, but to a lesser extent, for families just above the poverty line. In both cases, non-elderly families are more likely to owe taxes than are the elderly. This shows the effect of the additional personal exemption for being 65 or over.

Third, when social security taxes are taken into account, the tax burdens on most poor and near-poor increase (Table 7). The burden on families with no earnings is not affected by FICA taxes, of course. Hardly any poor or near-poor families with earnings receive net tax refunds (refunds of EITC in excess of FICA tax)—only 14 percent of the poor and 3.5 percent of the near poor.

Change in The Tax Burden of the Low Income Population

How the tax burden on the low income population has changed in recent years is more difficult to quantify with any confidence, in part because data for 1983 are not yet available. As part of Treasury's tax reform study, we are preparing a data base for 1983 that should enable us to answer many of these questions. From one perspective, the relative tax burden on low income households appears to have fallen. Between 1978 and 1982, the share of total federal personal income tax revenues generated by the lowest quintile of taxpayers fell, from 2.4 percent to 2.1 percent, while the share paid by the top 5 percent of taxpayers rose, from 31.2 percent to 33.1 percent. These figures do not adequately describe the problem, however, because they deal only with the distribution of tax payments within the taxpaying population. Since the tax threshold has not kept pace with increases in the poverty level, inflation has brought more tax units with incomes at or below poverty-level into the tax system. We do not know with certainty how many fall into this category.

The number of low income taxpayers would have increased less if indexing were already in effect. For example, if indexing had begun in 1979 (the last time the ZBA and personal exemptions were increased), in 1982 the exemption would have been \$1,330 and the ZBA would have been \$3,060 for single returns and \$4,520 for joint returns. There would have been 5.2 million, or 29 percent fewer taxpayers with AGI of \$10,000 or less in 1982.

Discussion

I would now like to make several concluding comments on these facts about the taxpaying status of the low income population.

The social security tax is the largest tax paid by the low income population. With social security being a self-contained system, the benefits that result from paying social security taxes need to be recognized in judging the fairness of the taxes. However, even though higher benefits are paid in the future, the working poor struggling to make ends meet may view their social security contributions much like other taxes. From the perspective of low income workers, it is important that the bipartisan compromise on social security adopted last year kept increases in social security taxes to a minimum and thereby kept this tax burden from rising higher.

Second, inflation is the major factor that has brought more low income people onto the tax rolls. Indexing will keep that from being a problem in the future. Indeed, repealing indexing would more seriously affect the tax liability of low than of high income people. As Table 8 indicates, repealing indexing would raise the income taxes paid in 1985 by those with incomes of \$10,000 or less by 10 percent; for taxpayers with incomes over \$100,000 taxes would rise by less than 2 percent.

The ERTA rate reductions are often criticized as favoring the wealthy because they reduced taxes for high income taxpayers by larger dollar amounts and by larger percentages of income than they did for low income taxpayers. But with a progressive tax system, an equal proportional cut in all rates will inevitably produce this result because under such a system the wealthy pay larger amounts of tax that represent larger fractions of their incomes. It should be remembered that the rate cuts in ERTA reduced most tax rates by roughly the same 23 percent. (While the top tax rate on unearned income was lowered from 70 to 50 percent, the lowest rate was reduced from 14 percent to 11 percent.) As a percentage of tax liability, however, the overall ERTA tax cuts were somewhat larger for low income than high income taxpayers. Tax liability under 1984 law for those with incomes under \$10,000 was reduced by 28 percent, but for taxpayers with incomes over \$200,000, by 19 percent. (This difference results from increases in the EITC for low incomes, the effect of the minimum tax, and the existence of the pre-ERTA maximum tax on labor income of 50 percent.) The ERTA rate cuts lowered 1984 taxes of taxpayers with incomes under \$10,000 by \$1.9 billion (calculated at 1982 levels of income).

Finally, now that this Administration has achieved its first goals of slowing inflation and getting the economy growing again, we are turning our attention to fundamental tax reform. The report that the Treasury Department will submit to the President in December will address issues of basic fairness.

TABLE 1.—SOURCES OF FEDERAL RECEIPTS, FISCAL YEARS 1954-88

(In percent)

Fiscal year	Income taxes			Social insurance taxes and contributions	Windfall profits taxes	Other excise taxes and customs duties	All other receipts ¹	Total receipts
	Individual	Corporation	Total					
1960.....	44.0	23.2	67.3	15.9	0	13.8	3.0	100
1961.....	43.8	22.2	66.0	17.4	0	13.6	3.0	100
1962.....	45.7	20.6	66.3	17.1	0	13.7	2.9	100
1963.....	44.7	20.2	64.9	18.6	0	13.3	3.1	100
1964.....	43.2	20.8	64.8	19.5	0	13.3	3.1	100
1965.....	41.8	21.8	63.6	19.0	0	13.7	3.7	100
1966.....	42.4	23.0	65.4	19.5	0	11.3	3.8	100
1967.....	41.3	22.8	64.1	22.0	0	10.5	3.4	100
1968.....	44.9	18.7	63.7	22.2	0	10.5	3.6	100
1969.....	46.7	19.6	66.3	20.9	0	9.4	3.4	100
1970.....	46.9	17.0	63.9	23.0	0	9.41	3.7	100
1971.....	46.1	14.3	60.4	25.3	0	10.3	4.1	100
1972.....	45.7	15.5	61.2	25.4	0	9.1	4.4	100
1973.....	44.7	15.7	60.4	27.4	0	8.4	3.8	100
1974.....	45.2	14.8	59.9	28.5	0	7.6	4.0	100
1975.....	43.8	14.6	58.4	30.3	0	7.2	4.1	100
1976.....	44.2	13.9	58.0	30.4	0	7.1	4.4	100
Transition quarter.....	47.8	10.4	58.2	31.0	0	7.0	3.8	100
1977.....	44.3	15.4	59.8	30.0	0	6.4	3.9	100
1978.....	45.3	15.0	60.3	30.3	0	6.2	3.2	100
1979.....	47.0	14.2	61.2	30.0	0	5.6	3.2	100
1980.....	47.2	12.5	59.7	30.5	1.2	4.9	3.7	100
1981.....	47.6	10.2	57.8	30.6	3.9	4.3	3.4	100
1982.....	48.2	8.0	56.2	32.6	² 3.1	² 4.2	3.9	100
1983.....	48.1	6.2	54.3	34.8	² 2.1	² 5.2	3.6	100
Projected: ³								
1984.....	44.0	9.8	53.8	35.9	1.3	5.7	3.3	100
1985.....	44.1	10.2	54.3	36.0	1.1	5.4	3.2	100
1986.....	44.8	10.7	55.5	36.4	.8	4.6	2.7	100
1987.....	45.4	10.9	56.3	35.9	.7	4.3	2.8	100
1988.....	45.9	10.5	56.4	36.8	.6	4.0	2.1	100
1989.....	46.4	10.1	56.5	37.1	.5	3.9	2.0	100

¹ Estate and gift taxes, deposits of earnings by the Federal Reserve System, and other miscellaneous receipts.² The allocation of excise taxes between windfall profits taxes and all other excise taxes for 1982 and 1983 is subject to revisions. Any reestimate of the percent of receipts attributable to windfall profits taxes will be offset by a reestimate of the percent attributable to all other excise taxes.³ Projections are based on the April 1984 update and are on a proposed law basis.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Apr. 11, 1984.

Note: Details may not add to totals due to roundings.

TABLE 2.—UNIFIED BUDGET RECEIPTS AS A PERCENT OF GNP, SELECTED SOURCES OF RECEIPTS, 1960-83

Fiscal year	Income taxes			Other non-social security receipts	Total non-social security receipts	Social security taxes	Total budget receipts
	Individual tax	Corporate tax	Both				
1960.....	8.2	4.3	12.5	3.8	16.3	2.3	18.6
1961.....	8.1	4.1	12.2	3.8	16.0	2.5	18.5
1962.....	8.3	3.7	12.1	3.8	15.8	2.3	18.2
1963.....	8.2	3.7	12.0	3.9	15.9	2.6	18.4
1964.....	7.9	3.8	11.7	3.8	15.5	2.7	17.7
1965.....	7.4	3.9	11.3	3.8	15.1	2.6	17.7
1966.....	7.7	4.2	11.8	3.4	15.2	2.9	18.1
1967.....	7.9	4.4	12.3	3.4	15.7	3.6	19.2
1968.....	8.3	3.4	11.7	3.3	15.0	3.5	18.5
1969.....	9.6	4.0	13.6	3.3	16.9	3.8	20.6

TABLE 2.—UNIFIED BUDGET RECEIPTS AS A PERCENT OF GNP, SELECTED SOURCES OF RECEIPTS, 1960-83—Continued

Fiscal year	Income taxes			Other non-social security receipts	Total non-social security receipts	Social security taxes	Total budget receipts
	Individual tax	Corporate tax	Both				
1970.....	9.3	3.4	12.7	3.2	16.0	4.0	20.0
1971.....	8.4	2.6	11.0	3.3	14.2	4.0	18.3
1972.....	8.4	2.8	11.2	3.2	14.4	4.1	18.5
1973.....	8.2	2.9	11.1	3.0	14.2	4.4	18.5
1974.....	8.6	2.8	11.4	2.3	14.3	4.8	19.1
1975.....	8.3	2.7	11.0	2.8	13.8	5.1	18.9
1976.....	8.0	2.5	10.5	2.8	13.3	4.9	18.2
1977.....	8.5	2.9	11.4	2.7	14.1	4.9	19.1
1978.....	8.7	2.9	11.5	2.6	14.1	5.0	19.1
1979.....	9.2	2.8	12.0	2.5	14.6	5.1	19.7
1980.....	9.5	2.5	12.0	2.7	14.7	5.4	20.1
1981.....	9.9	2.1	12.1	3.1	15.1	5.7	20.8
1982.....	9.8	1.6	11.4	3.0	14.3	5.9	20.2
1983.....	8.9	1.1	10.1	2.8	12.8	5.8	18.6

Source: Office of the Secretary, Office of Tax Analysis, Apr. 11, 1984.

TABLE 3.—TAXPAYING STATUS OF THE POPULATION UNDER THE INDIVIDUAL INCOME TAX, BY SIZE OF ADJUSTED GROSS INCOME

[1982 incomes, 1984 law]

AGI	All units, filers and nonfilers (millions)	Liability as percent of total units		Distribution of total taxes	Average taxes paid	Taxes as percent AGI
		Positive tax	Negative tax			
Less than 1,000.....	19.5	0	4.5	-0.01	-\$40	(¹)
1,000 to 3,000.....	10.1	1.0	6.4	-.05	-157	-7.5
3,000 to 5,000.....	8.3	54.0	11.6	.01	6	.1
5,000 to 7,000.....	6.9	67.4	19.8	.3	123	2.1
7,000 to 10,000.....	10.3	85.9	11.3	1.8	425	5.0
10,000 to 15,000.....	13.9	98.0	0	5.4	968	7.8
15,000 to 20,000.....	10.9	98.3	0	7.3	1,647	9.5
20,000 to 30,000.....	15.9	99.3	0	18.6	2,709	11.0
30,000 to 50,000.....	14.3	99.6	0	29.8	5,103	13.6
50,000 to 100,000.....	3.7	99.8	0	18.3	12,039	18.8
100,000 to 200,000.....	.6	99.6	0	9.2	34,956	26.5
200,000-plus.....	.2	99.7	0	9.4	129,822	32.9
Total.....	115.7	67.4	4.3	100	2,935	13.3

¹ Figure not meaningful since class includes returns with negative incomes.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Apr. 11, 1984.

TABLE 4.—TAXPAYING STATUS OF THE POPULATION—INDIVIDUAL INCOME AND FICA TAXES, BY SIZE OF ADJUSTED GROSS INCOME

[1982 incomes, 1984 law]

AGI	All units, filers and nonfilers (millions)	Liability as percent of total units		Distribution of total taxes	Average taxes paid	Taxes as percent AGI
		Positive tax	Negative tax			
Less than 1,000.....	19.5	65.0	3.7	1.2	328	(¹)
1,000 to 3,000.....	10.1	80.7	5.5	.4	179	8.9
3,000 to 5,000.....	8.3	80.5	9.8	.7	319	8.0
5,000 to 7,000.....	6.9	87.1	8.4	.9	511	8.5
7,000 to 10,000.....	10.3	98.1	.2	2.7	948	11.2
10,000 to 15,000.....	13.9	99.7	0	6.6	1,729	13.9

TABLE 4.—TAXPAYING STATUS OF THE POPULATION—INDIVIDUAL INCOME AND FICA TAXES, BY SIZE OF ADJUSTED GROSS INCOME—Continued

[1982 incomes, 1984 law]

AGI	All units, filers and nonfilers (millions)	Liability as percent of total units		Distribution of total taxes	Average taxes paid	Taxes as percent AGI
		Positive tax	Negative tax			
15,000 to 20,000.....	10.9	99.8	0	8.4	2,767	15.9
20,000 to 30,000.....	16.9	100.0	0	20.4	4,338	17.6
30,000 to 50,000.....	14.3	100.0	0	29.8	7,509	20.1
50,000 to 100,000.....	3.7	100.0	0	15.5	15,046	23.6
100,000 to 200,000.....	.6	100.0	0	6.8	38,077	28.9
200,000 plus.....	.2	99.9	0	6.5	13,277	33.6
Total.....	115.7	90.0	2.3	100.0	3,367	19.2

¹ Figure not meaningful since class includes returns with negative incomes.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Apr. 11, 1984.

TABLE 5.—NONTAXABLE HIGH INCOME RETURNS, 1970-81

Year	AGI > \$200,000	
	Number of returns (nontaxable)	Nontaxable returns as percent of all returns
1981.....	226	0.4
1980.....	143	.3
1979.....	70	.2
1978.....	98	.2
1977.....	60	.2
1976.....	68	.3
1975.....	260	3.1
1974.....	244	2.9
1973.....	164	2.0
1972.....	108	1.6
1971.....	82	1.2
1970.....	111	2.1

Source: 1981 Statistics of Income.

TABLE 6.—FEDERAL INCOME TAX BURDENS ON FAMILIES BELOW OR SLIGHTLY ABOVE THE POVERTY LEVEL, BY EARNING STATUS AND AGE, 1982

Type of family	Income below poverty level				Income between 100-150 percent poverty level			
	Percent with positive tax liability	Percent with negative tax liability	Taxes as percent income	Average tax	Percent with positive tax liability	Percent with negative tax liability	Taxes as percent income	Average tax
All families.....	9.9	20.1	-2.2	-131	45.4	8.4	3.5	355
With earners.....	18.9	40.3	-2.3	-135	72.7	13.9	3.5	359
Elderly.....	4.7	9.2	-.8	-58	20.5	5.1	1.9	207
Nonelderly.....	19.6	41.9	-2.3	-135	77.5	14.7	3.5	362
Without earners.....	1.0	0	1.9	98	3.6	0	3.3	240
Elderly.....	.3	0	.2	8	1.5	0	2.1	146
Nonelderly.....	1.5	0	2.1	110	11.2	0	3.8	284

Notes: 1. Income is family income, including cash transfers. 2. Taxes as percent of income and average taxes are for families with non zero tax liability.

TABLE 7.—FEDERAL INCOME AND FICA TAX BURDENS ON FAMILIES BELOW OR SLIGHTLY ABOVE THE POVERTY LEVEL, BY EARNING STATUS AND AGE, 1982

Type of family	Income below poverty level				Income between 100-150 percent poverty level			
	Percent with positive tax liability	Percent with negative tax liability	Taxes as percent income	Average tax	Percent with positive tax liability	Percent with negative tax liability	Taxes as percent income	Average tax
All families.....	35.7	14.0	3.5	\$173	58.0	3.5	8.7	\$866
With earners.....	70.7	28.1	3.6	174	93.6	5.7	8.8	881
Elderly.....	84.8	7.3	2.3	117	90.7	4.5	3.4	271
Nonelderly.....	70.0	29.2	3.6	177	93.9	5.8	9.1	934
Without earners.....	1.0	0	1.9	98	3.6	0	3.3	240
Elderly.....	.3	0	.2	8	1.5	0	2.1	146
Nonelderly.....	1.5	0	2.1	110	11.2	0	3.8	284

Note: 1. Income is family income including cash transfers. 2. Taxes as percent of income and average taxes are for families with non zero tax liability.

TABLE 8.—EFFECT OF REPEALING INDEXING, DISTRIBUTED BY EXPANDED INCOME CLASS

[1982 levels of income, 1985 law]

Expanded income class (thousands)	1985 law tax liability		Change in 1985 law tax liability due to repeal of indexing		
	Amount (millions)	Percentage distribution	Amount (millions)	Percentage distribution	Change in tax as percentage of tax liability
Less than \$10.....	\$4,360	1.8	\$436	6.2	10.0
\$10 to \$15.....	12,422	5.2	519	7.4	4.2
\$15 to \$20.....	17,004	7.2	616	8.8	3.6
\$20 to \$30.....	43,148	18.2	1,459	20.8	3.4
\$30 to \$50.....	69,353	29.3	2,269	32.3	3.3
\$50 to \$100.....	43,222	18.3	1,210	17.2	2.8
\$100 to \$200.....	21,978	9.3	372	5.3	1.7
\$200 or more.....	25,190	10.6	143	2.0	.6
Total.....	236,677	100.0	7,023	100.0	3.0

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Apr. 11, 1984.

Note: Details may not add to totals due to rounding.

Chairman RANGEL. Let me thank you for the eloquence with which you have presented the administration's position. We are looking forward to the December report as it relates to tax fairness for the poor, as well as the December report to the President on the problems of the deficit.

And so, I recognize the administration is going to have a full load in December. But since your full statement will appear in the record, maybe you can now begin to help us before December in seeing what we can do to remedy a situation that I would like to call just an oversight. I think you would agree that the indexing is a great reform—yet, it was the administration that said it should begin in 1985, and if they want fairness to begin then we do not have a problem with it, because that is going to be the law. This does not mean, however, that the poor should have to wait for fairness until 1985.

Even if we did have the indexing I think your testimony clearly points out that there would be factors other than inflation which would cause the poor to not be able to benefit to the same extent as the more affluent worker. We do not have any problem with saying

that the more money you make, the more taxes you pay, so when there is an across-the-board reduction, the poor will pay less taxes.

It just means that if you take into consideration what people can do realistically with the money that they have, then equal across the board does not necessarily mean that it is equal. I mean, the poor have a lot more problems in terms of survival than the wealthy, and so we have to do a little better than "equal."

We have to try to be just and not use a percentage, whereby someone is making \$10,000 and someone is making \$100,000 and we would say 10 percent for everybody and thus say this is fair.

One of the mechanisms which the administration has supported is the earned income tax credit, and as you pointed out there is a provision regarding this in the Senate bill. I assume that you accept this as one of the vehicles that can be used by the Congress and the administration to bring about a more just sense of fairness for the working poor?

Mr. McLURE. Certainly, the administration feels that the earned income tax credit is quite a valuable innovation in the fiscal arsenal to try to differentiate between various families.

Chairman RANGEL. Now, are you prepared to say to what extent the administration would be prepared to assist the House in expanding the Senate provision in conference?

Mr. McLURE. Not at this time, no, sir.

Chairman RANGEL. It was reported yesterday on the floor that the administration supports the House tax bill, and I had not read or heard that. Is that a fact?

Mr. McLURE. I believe so.

Chairman RANGEL. I suppose it is supported by the President in the same tone in which you responded. [Laughter.]

That being the case, and assuming that they support the Senate bill, too, this would be an excellent time to see what we can do this time to take advantage of the preliminary findings of your December report. As we move forward to make this downpayment on the deficit, the third step in the President's initial Economic Recovery Tax Act, and if we in conference are going to be supportive of the President's policy, and since it is clear that somehow the problems of the poor and the low income were not included previously—I mean, they were set aside to be studied until December—it would seem to me that it would make a lot of sense, to see whether or not the administration can bring some recommendations to that conference to relate to this group of people that I kindly say was overlooked in the tax policy.

So I am asking you, in the spirit of cooperation, to please have Mr. Chapoton take a look at those things that he would find acceptable to deal with in conference, because I am certain that there would be a lot of other recommendations that the administration would find that it cannot live with, or that it needs more time or that it would have to study.

I would like to ask, has a study been made of how many individuals have taken advantage of the Tax Code, pay no taxes at all in the higher income as opposed to lower income?

Mr. McLURE. Yes, sir. Part of the statement that I did not read dealt with that.

Chairman RANGEL. What was that?

Mr. McLURE. With an AGI of \$200,000 or more, there were 226 returns in 1981 where there was no income tax liability. Now, if we adjust that for the number of taxpayers that pay taxes to foreign governments that are creditable against the U.S. tax, then that number drops to 79.

I think since the minimum tax was tightened in 1975 many fewer top bracket returns are now totally avoiding paying any U.S. tax.

Chairman RANGEL. We did not know that the administration was having this ongoing study to see the impact of tax policies on the poor and low income. Exactly what is the title of this group that is studying it, and who are they?

Mr. McLURE. Well, the study of the tax situation of the low income population and of families in general is simply part of the overall study of fundamental tax reform that the Treasury has undertaken at the direction of the President.

Chairman RANGEL. So there is no specific group that is looking into the impact of tax policy on the poor? This is just an overall review of tax policy for everybody, right?

Mr. McLURE. Certainly, but I think there would clearly be something missing if we were not looking at the tax status of the poor.

Chairman RANGEL. But I think you agreed with me that this was missing when the President submitted his tax bill to me in 1981.

Mr. McLURE. I did not say that, sir.

Chairman RANGEL. What I am saying is, we do not want to get caught in the same position, that you are looking over the tax policy for the entire country, and the poor are going to get the same attention they got before, because that is no attention. What I hope we are saying is that a lot of things were overlooked when the President was concerned with the general economic recovery, that it was his opinion that if you could reduce inflation the poor would be the beneficiaries, and when it dealt with specific legislation, that the administration did not focus on it.

Now they are, and it is a part of this report that you have, and what I am saying is that, one, this is a great opportunity for us to move forward and try to protect these people before we move next year into just increasing revenues, which is going to be the main thing, no matter who the President is, and second, I was only trying to identify, Mr. McLure, who we could work with.

Now, Secretary Chapoton is a great man to work with in conference, but it would not be fair to him or to us unless we made certain that he had available at least the preliminary work. And so what I am asking is, who can we work with to deal with this specific problem?

Mr. McLURE. I think the best answer would be to deal directly with me or with Mr. Chapoton.

Chairman RANGEL. I want staff to prepare a letter indicating all of the provisions that we have recommended in legislation prepared by members of this committee. We will just submit the entire thing subject to the parliamentary situation we find ourselves in in conference.

Mr. Guarini.

Mr. GUARINI. Thank you, Mr. Chairman.

Dr. McLure, under our tax laws, is it not true that a wealthy man can make millions of dollars and reduce his tax responsibilities to zero?

Mr. McLURE. It would be fairly difficult because of the minimum tax, but as the figures that I read a few minutes ago indicate, yes, it is possible.

Mr. GUARINI. So the wealthy can virtually reduce their tax to zero except for a minimum tax, but the working poor have no opportunity of reducing their tax in the same capacity that a wealthy man has of reducing his tax. I think that is understood. Is that not so?

Mr. McLURE. The earned income tax credit does offer the poor the opportunity of not only paying no tax, but also of actually having a refund that will largely, not totally, offset the social security taxes paid. Obviously, there is some difference in the way these provisions work.

Mr. GUARINI. When the wealthy are able to reduce their taxes to a minimum or to zero, then the burden must necessarily fall on the working person and the working poor. Is that true? Because somewhere in the equation you have to pick up this money, so the more breaks and tax shelters we give the wealthy person, that has to be absorbed by the lower class working people.

Mr. McLURE. Certainly the taxes have to be paid by someone.

Mr. GUARINI. Now, knowing that this is so, is there any suggestion or recommendation that you could make in our tax laws where there would be more fairness and equity in this kind of situation?

Mr. McLURE. At this point we are not ready to make recommendations.

Mr. GUARINI. Well, at what point would we? We are in 1984. We have got a nation that is in a tremendous fiscal crisis, and we have more people slipping under the poverty level, so I am wondering what your positive recommendations are, and if you have none to make, when will they be made?

Mr. McLURE. Well, as you know, the Internal Revenue Service is increasingly trying to crack down on so-called abusive tax shelters, some of the things that make it possible for high income individuals to avoid the taxes they should rightfully be paying. In addition, as part of the fundamental reforms that we are looking at, we will examine the entire question of tax shelters, not just abusive tax shelters, but shelters in general.

Mr. GUARINI. All right, then. There are loopholes in tax shelters which the administration will look at in order to make the code more fair so that the working people will not have to bear that greater part of the tax load.

Mr. McLURE. Certainly. By the same token we are considering the tax burden on the poor as part of the fundamental reform. We are also looking at the tax burden on other groups as part of the fundamental reform, and we are trying to produce a system that everyone will agree is simpler, fairer, more neutral.

Mr. GUARINI. Well, is it not an accepted fact that in our present posture of the Tax Code, that it is so skewed that the rich are getting richer, and that there is polarization of the poor and the working poor?

Mr. McLURE. I think it would be difficult to say that. Despite the kind of loopholes to which you allude, the tax system does remain basically progressive overall.

Mr. GUARINI. Well, are there not more people falling into the category of making more than \$200,000 a year while we still have people that are slipping under that \$9,800 poverty line?

Mr. McLURE. Well, sure. More people are falling into the \$200,000 or more category, but that is in part just the result of economic growth and in part the result of inflation.

Mr. GUARINI. Well, our inflation has slowed to 3 or 4 percent. Now we are talking a few years ago, but speaking as we now stand today, do you not accept the fact that there are more people becoming wealthy and still in our society there are more people that are disadvantaged?

Mr. McLURE. I do not think I could speak with authority on that.

Chairman RANGEL. I do not think that is disputed. He is not asking whether or not this administration is responsible for it. I could answer that. But that is a political question. The statistical data from Census is here, and they have the responsibility of determining how people's income over time changes. Today we have more people, and probably more people paying taxes because there were more wealthy people created in the last 3½ years than probably in the last decade. The President does not apologize for that fact.

He thinks that is a part of America. So the answer to that question is yes. Then we have Census following you, and they also say there are more poor folks than ever before. So it is not a political question, and we are not attaching blame, but what we want to know is if that is a fact, what can we do to close the gap?

Mr. GUARINI. Exactly. Do you have any recommendations on how we can close the gap?

Mr. McLURE. I think it would be premature for me to speculate on that before we finish the study that will be due in December.

Mr. GUARINI. All right. Let me ask you, let us take the working class people that we have, the middle class working people that we have. Do your statistics show that there is a shrinkage in their ability to keep up with the income, or with the economics of our time?

Mr. McLURE. I would say that there has been a little slippage, not a lot, but I think that the administration's program has done a great deal in getting the economy moving, reducing inflation, making it possible for more people to have jobs, buy homes, provide for their families.

Mr. GUARINI. But the person who is working, a blue collar worker, would you statistically show that he is not as well off as he used to be, as far as his ability to meet the cost of living?

Mr. McLURE. I think in order to answer that I would have to look at particular statistics and get back to you and provide that for the record.

Mr. GUARINI. You have no statistics to present to us at this time on that subject matter?

Mr. McLURE. We certainly have them. They are just not at my fingertips.

[The information follows:]

The following table shows that a typical blue-collar worker and family had less real after-tax income in 1983 than in 1978. This results much more from the decline in real earnings than from the increases in taxes, however. Real earnings fell by \$1,437 while taxes rose by \$140 in 1983 dollars.

TABLE 1.—COMPARISON OF TAX BURDENS FOR A FAMILY OF 4 WITH 1 BLUE-COLLAR WORKER, 1978 AND 1983¹

	In 1983 dollars		In 1978 dollars
	1983	1978	1978
Total earnings.....	\$14,734	\$16,171	\$10,592
Federal income tax.....	973	841	551
Payroll tax.....	987	979	641
Total tax.....	1,960	1,820	1,192
After-tax income.....	12,774	14,355	9,400

¹ 1 earner working year-round and earning the average gross weekly earnings for a production or nonsupervisory worker.

The \$422 increase in Federal income taxes—from \$551 in 1978 to \$973 in 1983—can be decomposed into four pieces. First, inflation alone raised taxes by \$290. Second, bracket creep led to a further tax increase of \$794. Third, however, tax law changes between 1978 and 1983 offset \$439, or more than half, of this effect of bracket creep. Finally, the decline in the real earnings of this typical family lowered the tax an additional \$223. The net result of these four effects was that federal income taxes on this typical family rose by \$422 between 1978 and 1983.

Mr. GUARINI. All right. Let us just talk about the people who are under the poverty line, under the \$9,800 gross poverty line. The regressive kind of taxes are excise taxes. Is that not so?

Mr. McLURE. Many excises are.

Mr. GUARINI. All right. Is there any way that these people are hurt by our tax laws that you could point out to us that we should look into?

Mr. McLURE. Well, the failure of the tax threshold to keep up obviously is of concern to the administration as well as to this committee. Also as I indicated in the testimony the Social Security taxes paid by the working poor obviously are a burden to them.

Mr. GUARINI. Well, now, you gave us one recommendation of do not repeal indexing. Knowing all of the statistics that you have, and knowing what the problem is today, are there any recommendations that are made in addition to that one caveat in regard to how we could help the plight of our disadvantaged and less fortunate and the low income people?

Mr. McLURE. No. Again, I think it would be inadvisable for us to be making recommendations at this stage, just as we are beginning this major study of fundamental tax reform.

Mr. GUARINI. And when will we expect to hear from the administration regarding any recommendations they have?

Chairman RANGEL. That depends upon which way the election goes.

Mr. GUARINI. That is what I am afraid of. [General laughter.]

Mr. McLURE. The President will hear from us in December. I am not privy to the rest of the timetable.

Mr. GUARINI. Thank you.

Thank you, Doctor. I understand.

Chairman RANGEL. Mr. Matsui?

Mr. MATSUI. Thank you, Mr. Chairman.

Mr. McLure, I have heard your testimony, and I have not seen a statement in here regarding whether there has in fact been an increase in the tax burden of a family of four making \$10,000 or less since 1978. Has there in fact been an increase in taxes for that family of four that makes \$10,000 and less since 1978 to the present time?

Mr. McLURE. Yes, sir. I believe so.

Mr. MATSUI. And do you happen to know exactly how much that tax increase is?

Mr. McLURE. I do not know it right at the moment. I can get back to you on that.

[The information follows:]

A family of four with \$10,000 of income in 1978 and 1983 would pay less Federal tax in 1983 than in 1978—\$963 vs. \$1,055, respectively. However, a family with a real income of \$10,000 in 1983 and 1978 would pay more Federal taxes in 1983 than in 1978—\$963 vs. \$242. (See Table 2.) In constant 1983 dollars, the \$242 tax bill was equivalent to \$370 of taxes in 1983.

TABLE 2.—TAX BURDEN ON FAMILY OF 4 (1 EARNER), 1983 AND 1978

	Income	Federal income tax	Payroll tax	Total tax
1983.....	\$10,000	\$293	\$670	\$963
1978.....	10,000	450	605	1,055
1978.....	¹ 6,548	-154	396	242

¹ \$10,000 in 1983 was worth \$6,548 in 1978.

Mr. MATSUI. It is substantial, is it not, however, when you include payroll taxes in?

Mr. McLURE. Yes; certainly the increase in the payroll tax is important. The failure to index is important. And the primary offset would be the increase in earned income credit.

Mr. MATSUI. What are basically your responsibilities at the Treasury Department? You are the deputy assistant for tax analysis. What basically are your functions?

Mr. McLURE. My staff consists of a group of economists who analyze tax policy, the economics of tax policy.

Mr. MATSUI. And how the burden affects various income groups?

Mr. McLURE. Among other things, yes.

Mr. MATSUI. You are then part of the group that is working on the study to develop a revision of the Tax Code and come up with the so-called tax reform package due next December. Is that right?

Mr. McLURE. Yes.

Mr. MATSUI. And at this time it is basically the Treasury Department's responsibility to make this recommendation? It is not shared by OMB or by Commerce or by any of the other departments?

Mr. McLURE. Yes; the President in the State of the Union Address requested the Secretary of the Treasury to prepare this report.

Mr. MATSUI. And you at this particular time are unwilling to give us any idea of what concepts you are using? For example, are you using the Laffer concept or are you using a Keynesian approach to prepare your report?

Mr. McLURE. I think—

Mr. MATSUI. Are you free to discuss this with us? Because frankly, you know, we might decide we do not need these hearings any more if you say, hey, look, we are thinking along this line. We might say, that is great.

Mr. McLURE. Well, as I indicated in my prepared statement any major overhaul of the tax system will obviously have many ramifications throughout the economy, including burdens on people at or near the poverty level. We are considering various ways to alleviate those burdens, such things as adjusting the ZBA, the dependency exemption, and the earned income credit. We are also looking at the relationship between taxes on the working poor and the non-working poor; at the taxes paid by families of various compositions, of various size, where they are headed by a single head of household as opposed to a married couple. We are looking at various techniques to adjust the tax burden on low-income families, and at the same time not give away massive amounts of revenue.

Mr. MATSUI. You, yourself, personally as an economist who is knowledgeable in the area of taxes and how it affects the budget, do you believe in the progressive system of taxation?

Mr. McLURE. I would say I believe in mild progressivity, that is, some graduation of rates at high income, but obviously, there is a wide range of interpretation that can be put on these words.

Mr. MATSUI. That makes me feel a little better. In 1981, when Dave Stockman appeared before our committee, when we discussed the issue of indexing and the 25-percent cut—at that time he was talking about a 30-percent cut—he indicated that the purpose of skewing these cuts so that the actual dollar amount was larger for those that were in the higher income brackets was to increase the savings rate of the United States—he referred to Japan, which had a 25-plus percent savings rate, and the fact that we were about 4.5 or 4.8 percent during that period—he has argued for the cuts, based upon the fact that more money would be available. This, in turn, would lead to more industrial growth. More jobs and more money would come to the Federal Treasury, and we would have a balanced budget by 1984, in fact, a \$500 million surplus by 1984, Don Regan, your boss, reconfirmed that scenario when he later appeared before the committee.

What is the savings rate today?

Mr. McLURE. I am not sure of the exact number. I think it is around 5 percent. I would have to check.

[The information follows:]

The latest estimate of the saving rate for the first quarter of 1984 is 5.8 percent, up from 4.9 percent for 1983.

Mr. MATSUI. It went up, then, about a half a percent or so?

Mr. McLURE. It certainly has not moved very much.

Mr. MATSUI. Do you feel that Mr. Donald Regan's statement and Mr. Stockman's statement are incorrect?

Mr. McLURE. I think it would be difficult to determine, because I think most econometricians would tell you that you cannot really tell that much from just a couple of years' evidence, so I think it would be very difficult to tell.

Mr. MATSUI. That is interesting, because I was told by most economists, the Bank of America economists, Chase economists,

that people, when they get the tax cut, will save for the first year or 6 months, and then slip back to their normal patterns. In fact, that has always been the historic situation. Are you telling me we could see a dramatic increase in the savings rate perhaps as a result of these cuts some time in the future?

Mr. McLURE. No; I am saying I simply do not know.

Mr. MATSUI. You are saying that it probably is not so, right? I mean, if you are an economist, you are not going to say anything that is not accurate before this committee. You know the savings rate is not going to go up substantially with these tax cuts, do you not?

Mr. McLURE. I think that the savings rate will go up. How much, and whether it is substantially, I do not know.

Mr. MATSUI. So you are not repudiating the statements made in 1981 by Regan and by Stockman?

Mr. McLURE. No.

Mr. MATSUI. Now, that bothers me. With respect to the earned income credit that the chairman had talked about, I did not quite understand your response. Are you prepared to offer some suggestions to the conference between the House and the Senate that might be a little more favorable to the poor than the current proposal in the Senate Finance package?

Mr. McLURE. I think the chairman did not actually ask for a response.

Mr. MATSUI. I am asking for a response, if you would not mind giving one.

Mr. McLURE. What I would like to do is to go back and discuss it with Mr. Chapoton.

Mr. MATSUI. Well, what would your recommendation be?

Mr. McLURE. To discuss it with Mr. Chapoton. I simply cannot make that kind of a statement.

Mr. MATSUI. Why isn't Mr. Chapoton here, then? We are discussing poverty. We are going to have a markup. And we are going to be having a conference in another 3 or 4 weeks. I would like to hear what the administration's position is on this. I would like to know your position. I mean, you are an individual. I am asking you as the Deputy Secretary for tax analysis. Do you think that we should increase it more than what the Senate Finance Committee has done?

Mr. McLURE. Sir, I do not think—I was not sent here to give my personal opinions on these matters.

Mr. MATSUI. Well—

Chairman RANGEL. If the gentleman would yield, Doctor, we need your personal opinions. We are not asking you to speak for the administration. They speak well for themselves. But you are a technician. You are a professional. We do recognize there is a problem. You are trying to bring some concrete recommendations to us in September. We are moving into conference, and we believe it is slightly unfair for the poor to wait to see what happens in the next administration.

If we are going to close this gap, we feel EITC is a way to do it, and we are asking you from a technical point of view, whether you agree.

Mr. McLURE. Sir, I would simply prefer to take the question to Mr. Chapoton and ask him to speak for the administration.

Mr. MATSUI. Well, you see, the problem with this is that we certainly would like to get some specifics from this administration. When are you going to develop it? The day after the conference? When will you be able to give us an answer on this thing?

Chairman RANGEL. After the election.

Mr. MATSUI. No; I mean in terms of this conference coming up. Maybe we could hold another hearing, Mr. Chairman, when we get back.

Chairman RANGEL. We think we would have time. Would you be agreeable to that type of scenario, in which we would have a hearing prior to the conference?

Mr. McLURE. If that is necessary. Yes, sir.

Mr. MATSUI. Do you think you will be able to have an answer by that time? You have got 2 weeks before we get back. The conference will occur 3 or 4 weeks from now.

Mr. McLURE. I would think so; yes.

Mr. MATSUI. And you would be able to give us an answer as to exactly how far you would go in increasing the earned income tax credit?

Mr. McLURE. I would hope so; yes.

Mr. MATSUI. That helps a little bit.

Chairman RANGEL. Sure. We will do that.

Mr. MATSUI. I do not have any further questions.

Chairman RANGEL. Thank you.

Will your committee take a look at aid to dependent children, the formulas AFDC has in terms of every dollar of income reducing a dollar of benefit? We have considered that on the tax committee that a taxing system of dollar for dollar, 100 percent, certainly affects the working poor; that is, those who are trying to work and receiving some assistance. Have you taken a look at that and seen whether or not the earned income disregard might be another vehicle which we could use to keep people working and at the same time reduce that 100 percent tax on these families.

Mr. McLURE. I think there is no doubt that we would keep in mind this effect as we are thinking about this kind of problem. Since we do deal with taxes rather than on the expenditure side, we would be less likely to make substantive proposals dealing with something like AFDC.

Chairman RANGEL. Well, it is all part of the tax system. You see, our problem is that you are going to have more help when you deal with reforms for the higher income people. They will be working with you every day. If we do not have people like you along with us, trying to target where the poor need help, they will not receive any help.

And these are working people. They are in the tax system just because this is an incentive for them to work, and so will you put that on the list, too, of what we can do?

And lastly, I would like to ask, do you have an independent view of the competency and bipartisanship of the Congressional Budget Office, and do their reports have any impact or influence at all on your office?

Mr. McLURE. First, I would not want to comment on their bipartisanship other than to say that they, I think, do have a well-deserved reputation for being unbiased. I think that was true under Alice Rivlin, and I presume it will be true under Dr. Penner.

Chairman RANGEL. You see, this is the research arm of the Congress, and we created it so that when you people come up with your reports, we at least would have a comparable report. Good thinking people can then come together and see whether the same standards or formulas were used. They recently, at the request of Senator Lawton Chiles, put out a report which indicated that the tax cuts have cost the poor substantially more than the rich, as the philosophy was to get to investment and really not to ease pain.

I am not arguing with you, but they did point out that households with annual incomes of less than \$10,000 have lost an average of \$390 a year. Incomes of \$40,000 to \$80,000 has gained something like \$2,900 a year. And families with more than \$80,000 of income have gained on the average of \$8,200 a year.

And I guess my question is whether you or your researchers or your committee would normally take a look at the CBO report before you made recommendations?

Mr. McLURE. Certainly. We have looked at it.

Chairman RANGEL. Could you respond to what you believe this means in terms of what we should be doing?

Mr. McLURE. Well, I think I would respond first by saying, in terms of the figures from that report that have gotten the most publicity, that one would not have expected anything very different. If you have a progressive system, when you have a more or less equal proportionate cut in all rates, clearly you are going to have higher tax cuts at upper-income levels than at lower-income levels in dollar terms and as a percentage of income.

The question I have asked myself repeatedly, and I would like for you to ask the CBO staff, if you wish, is why they did not report what most economists would have reported in the study, which is the change in tax as a percentage of the tax or, that is, the percentage reduction in tax.

Chairman RANGEL. But is not this statistical data? You are talking about fairness. Of course, we would agree that the more taxes you pay when you have 1 percentage decrease, that decrease would be more among those at higher incomes than the poor. But if you were to put a head tax on every American of \$100, you would not say that is fair, either, would you? No; you would just say each citizen pays, \$100, and then you would say, we did it equally and we treated everyone alike. That would not be fair.

Mr. McLURE. No; I do not think most people would call it fair.

Chairman RANGEL. OK, so it has taken 3½ years to talk about how we can be more fair, but since those in the lower income are incorporated in some broader study for the purposes of our next meeting, is it generally agreed that we will pull out part of the general study that relates to the low income and the poor for a quick review before we go into conference?

Mr. McLURE. I think—the response I gave earlier, I think, was that I would take to Mr. Chapoton the question of whether or not we would be able to support any kind of change in the Senate proposal on the earned income credit.

Chairman RANGEL. Expansion, not change. Just so that we are clear.

Mr. McLURE. OK. An increase. That is what I thought I was saying.

Chairman RANGEL. OK, great. That is agreed to. Will you also ask the Secretary whether or not on the question of fairness of the tax system that has been locked into place since the Economic Recovery Act and since the Reform Act, and whether or not we can put on a faster track those questions of equity and fairness as they relate to the lower income people. If we can get this issue out with whatever you have before the tax conference, then a lot of us who intend to be conferees could be more supportive of the overall package. I think Mr. Chapoton would understand that, and we will put that type of language in a letter to him before we have a recess.

Your full statement is in the record. Is there anything you would like to add to it?

Mr. McLURE. No, thank you.

Mr. MATSUI. May I ask another question?

Chairman RANGEL. Sure.

Mr. MATSUI. Dr. McLure, I know what happened in 1981. The administration came up with a proposal. We came up with a proposal. The administration did not pick up what we did in addition to their proposal, and so there was somewhat of a bidding war going on, and I suppose from a political point of view I can understand why the administration did pick up our proposal to expand the EITC, because there were no additional votes to be gained by doing that. But why did not the administration do that when they came up with the proposal to index income by 1985? Why did they not say at the same time, we will index the EITC as well, just out of curiosity? I am just interested in knowing that.

Mr. McLURE. I am really not sure.

Mr. MATSUI. Were you in the administration then?

Mr. McLURE. No.

Mr. MATSUI. Thank you.

Chairman RANGEL. Thank you very much, Mr. Secretary.

Mr. McLURE. Thank you, sir.

[Answers to questions submitted to the Department of the Treasury follow:]

COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC, April 19, 1984.

Dr. CHARLES E. McLURE, Jr.,
Deputy Assistant Secretary for Tax Analysis,
U.S. Department of Treasury, Washington, DC.

DEAR DR. McLURE: On behalf of the Subcommittee on Oversight, I wish to thank you for testifying on the federal tax treatment of low income individuals. Your statement was important in aiding the Subcommittee's inquiry into the recent increases in federal taxes on the poor.

Attached are several questions which we would like answered for the record.

Again, I very much appreciated your testimony.

Sincerely,

WILLIAM A. KIRK,
Staff Director.

Enclosure.

1. In the enclosed Committee print, Table 3 shows that taxes on poverty level earnings have increased from \$269 in 1978 to \$1,166 in 1985 for a family of four. As a percentage of income, this is an increase from 4.0 percent to 10.5 percent. Other family sizes show similar increases. Why has the Administration allowed taxes on families with poverty level earnings to increase so dramatically?

2. Since 1978, has the tax burden on the poor increased or decreased?

(a) As a percentage of income?

(b) In comparison to the average tax rates of other income groups?

3. When the Administration proposed indexation as part of its 1981 tax reduction program, why didn't the Administration also propose indexing the earned income tax credit?

4. What percentage of eligible households participate in the earned income tax credit program? What efforts does the Internal Revenue Service undertake to increase the participation rate?

5. On page 8, of your prepared testimony, you state that if indexing had begun in 1979, 20 percent fewer taxpayers with AGI below \$10,000 or less would be paying taxes. How much less tax would be paid in 1984 by families below poverty if indexing had begun in 1979?

6. On page 5, of your prepared statement, you argue that payroll taxes for low-income workers must be compared to their future potential benefits. Taking into account life expectancy and labor force attachment of low income versus high income workers, how does the present value of benefits compare to taxes under OASDI for these workers. What is the present value of tax savings for high income professionals in qualified pension plans? What is the present value of tax savings of IRA contributions to a taxpayer in the 50 percent marginal tax bracket? How does that compare to low income workers in social security? After subtracting Supplemental Security Income benefits?

7. The Tax Reform Act of 1976 requires the Department of Treasury to publish information annually on the amount of tax paid by individual taxpayers with high total incomes. Specifically, the statute requires publication of the number of individuals with total incomes of over \$200,000 who owe no Federal tax and the deductions, exclusion, or credits they use to avoid tax.

(a) How many taxpayers fall into such a category?

(i) \$100,000 +

(ii) \$150,000 +

(iii) \$200,000 +

(b) How many of these individuals pay little or no tax year after year?

(c) How many taxpayers are able to reduce their taxable income by 50 percent through the use of deductions, exclusions or credits with income over—

(i) \$100,000 +

(ii) \$150,000 +

(iii) \$200,000 +

DEPARTMENT OF THE TREASURY,
Washington, DC, August 13, 1984.

Mr. WILLIAM A. KIRK,
Staff Director, Committee on Ways and Means, Subcommittee on Oversight, House of Representatives, Washington, DC.

DEAR MR. KIRK: Attached are answers to the questions you raised in your letter of April 19 in regard to my April 12 testimony before the Subcommittee on Oversight. I regret the delay in responding, but I hope the answers are helpful.

Sincerely,

CHARLES E. McLURE, Jr.,
Deputy Assistant Secretary (Tax Analysis).

Enclosure.

ANSWERS BY DR. CHARLES E. McLURE, JR., DEPUTY ASSISTANT SECRETARY OF TREASURY (TAX ANALYSIS), TO QUESTIONS POSED BY WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT IN LETTER FROM WILLIAM KIRK, APRIL 19, 1984

(1) In the enclosed Committee print, Table 3 shows that taxes on poverty level earnings have increased from \$269 in 1978 to \$1,166 in 1985 for a family of four. As a percentage of income, this is an increase from 4.0 percent to 10.5 percent. Other family sizes show similar increases. Why has the Administration allowed taxes on families with poverty level earnings to increase so dramatically?

Answer. The Administration's economic policies have kept the tax burdens on low-income families from rising even further. If inflation had continued at the rate prevailing before this Administration took office, the poverty-level family of four in 1983 would have owed 73 percent more in Federal taxes than it actually did—\$553 instead of \$319. Similarly, without the ERTA rate cuts, a family of four at the poverty level in 1983 would have owed \$402 in taxes, or 26 percent more than it actually did. It should also be noted that a large portion of the increase between 1978 and 1983 came in payroll taxes.

(2) Since 1978, has the tax burden on the poor increased or decreased?

(a) As a percentage of income?

Answer. As indicated in table 3 of Section 10 of the October 17, 1983, "Background Material on Poverty," prepared by the Ways and Means Committee staff, the tax burden on the poor has increased since 1978.

(b) In comparison to the average rates of other income groups?

Answer. The following table compares the increase in the tax burden on a family of four at the poverty line with changes in the tax burden of similar families with incomes of 50 percent, 100 percent, and 200 percent of median income. This table shows that the increase in tax burdens was indeed greater for a four-person, one-earner family at the poverty level than at higher income levels.

TAX BURDENS FOR 4-PERSON FAMILIES, 1978 AND 1983

Income	Federal income tax as percent of income		Federal income plus FICA taxes as percent of income	
	1978	1983	1978	1983
Poverty.....	0.5	4.1	6.5	10.8
One-half median.....	4.7	5.7	11.7	12.4
Median.....	11.1	11.1	16.3	17.8
Twice median.....	17.4	18.4	20.0	22.6

(3) When the Administration proposed indexation as part of its 1981 tax reduction program, why didn't the Administration also propose indexing the earned income tax credit?

Answer. The Administration did not initiate the proposal for indexing. The proposal originated in Congress and was endorsed by the Administration.

(4) What percentage of eligible households participate in the earned income tax credit program? What efforts does the Internal Revenue Service undertake to increase the participation rate?

Answer. Virtually 100 percent of the eligible tax filing population participates in the program. The IRS, in checking the calculation of taxes on each tax return filed, gives eligible tax returns the EITC which they are due, even if the tax filers did not claim them. The number of nonfilers who would be eligible for the EITC is uncertain but probably fewer than one million. The IRS does take steps to encourage nonfilers eligible for the EITC to file. These include routinely preparing announcements—in clear English and Spanish—for newspapers, radio and television explaining the issue.

(5) On page 8, of your prepared testimony, you state that if indexing had begun in 1979, 20 (sic) percent fewer taxpayers with AGI below \$10,000 or less would be paying taxes. How much less tax would be paid in 1984 by families below poverty if indexing had begun in 1979?

Answer. Under 1984 law and 1982 levels of income, we estimate that \$2.5 billion, or 51 percent, less tax would be paid by tax units with income of \$10,000 or less. (At present, our data do not allow us to present analyses according to poverty status. The poverty level applies to families, whereas our data are based on tax units. As part of the tax reform study that Treasury is currently conducting, we are developing a data base that will allow us to perform such analyses in the future.)

Please note that page 8 of my testimony indicates that 29 percent, not 20 percent, fewer taxpayers with incomes of \$10,000 or less would be paying taxes under 1982 law and 1982 levels of income.

(6) On page 5, of your prepared statement, you argue that payroll taxes for low-income workers must be compared to their future potential benefits.

A. Taking into account life expectancy and labor force attachment of low-income versus high-income workers, how does the present value of benefits compare to taxes under OASDI for these workers?

Answer. A comparison of the present value of social security benefits and taxes depends on many factors besides the earnings of the worker, including age, sex, race, and marital status. The table below presents the most recent information available that incorporates the effects of the Social Security Amendments of 1983. Figures are not available, however, which would reflect differences in life expectancies or in labor force attachments.

PRESENT VALUE OF OASI RETIREMENT BENEFITS AT AGE 65 AS PERCENTAGE OF COMBINED
EMPLOYER-EMPLOYEE OASI TAXES ACCUMULATED WITH INTEREST TO AGE 65

	Average-wage earner		Maximum-wage earner	
	Single man	Married couple ¹	Single man	Married couple
Age in 1985:				
65.....	176	330	151	283
55.....	129	241	102	191
45.....	104	195	80	149
40.....	97	180	72	134
35.....	94	175	68	126
25.....	86	160	58	108

¹ Assumes only 1 percent.

B. What is the present value of tax savings for high-income professionals in qualified pension plans?

Answer. Information is not available to answer this question.

C. What is the present value of tax savings of IRA contributions to a taxpayer in the 50 percent marginal tax bracket?

Answer. For a 40-year-old taxpayer in the 50 percent bracket who contributes \$2,000 per year to an IRA from 1985 to 2010 when he turns 65, then retires and moves to the 25 percent tax bracket as he draws down the fund over the rest of his life, the present value in 2010 of the past and future tax savings on the IRA would equal \$90,400. (These estimates use the same interest and mortality rate assumptions as the preceding table.)

D. How does that compare to low-income workers in social security? After subtracting Supplemental Security Income benefits?

Answer. The date on benefit-contribution ratios for low-income workers are not available, but they would be higher than the figures reported for average wage workers in the table above. As the table indicates, for an average wage earner turning 65 in 2010 (i.e., who was 40 in 1985), the present value of social security retirement benefits is 3 percent less than employer plus employee contributions plus interest up to age 65 if the worker is a single man. If the worker is married (with a nonworking spouse) the benefits exceed contributions by 80 percent.

This latter ratio is in the same range as the benefit-contribution ratios on the high-income taxpayer's IRA: The present value of tax savings on the IRA amounts to 73 percent more than the individual's contribution plus all interest, that is, more than the account's balance in 2010 plus the present value of the interest the account continues to earn until it is exhausted. It is 100 percent greater than the individual's contributions plus interest up to age 65.

Estimates of social security benefit-contribution ratios that take Supplemental Security Income into account are not available.

(7) (a) How many taxpayers fall into such a category?

- (i) \$100,000 +
- (ii) \$150,000 +
- (iii) \$200,000 +

Answer. In 1981, 1712, or 0.3 percent, of the tax returns with AGI between \$100,000 and \$200,000 owed no income tax. Two-hundred and twenty-six, or 0.2 percent, of returns with AGI of \$200,000 or more owed no tax.

(b) How many of these individuals pay little or no tax year after year?

Answer. Historical information on taxpayers is not available to allow us to answer this question.

(c) How many taxpayers are able to reduce their taxable income by 50 percent through the use of deductions, exclusions or credits with income over—

- (i) \$100,000 +
- (ii) \$150,000 +
- (iii) \$200,000 +

Answer. The information with which to answer this is available only for returns with \$200,000 or more of income. In that group in 1981, taxable income represented 50 percent or less of AGI for 12.7 percent of the returns. (Of course, credits do not reduce taxable income.)

Chairman RANGEL. Now, John Coder, Chief, Income Statistics Branch, Bureau of the Census. We have your statement, and as always, we are glad that you are able to share your views with us. Your full statement will be in the record.

We are concerned as to what has happened to the American population. We are concerned as to whether or not Government policy, budgetary policy, and tax policies have been a factor placing more people below the poverty line. You can fashion your testimony in such a way that is consistent with your discipline, with the understanding that this committee does not just want to know what the facts are. We want to be in a position to do something about it to close that gap. I think you have heard the administration's testimony that the gap factor was not really a consideration when they recommended the Economic Recovery Act, and while they want to wait until December, we hope we can get something done in May.

So, you may proceed in any manner you wish.

**STATEMENT OF JOHN F. CODER, CHIEF, INCOME STATISTICS
BRANCH, BUREAU OF THE CENSUS, DEPARTMENT OF COM-
MERCE, ACCOMPANIED BY GORDON GREEN, ASSISTANT DIVI-
SION CHIEF, POPULATION DIVISION**

Mr. CODER. Thank you, Mr. Chairman, for giving the Census Bureau the opportunity to participate in this hearing on the Federal tax treatment of low-income persons. To my right this morning is Gordon Green, Assistant Division Chief in the Population Division, who oversees all of the collection of poverty statistics at the Bureau.

The Bureau, as you know, has been a source of official estimates of poverty since 1969. This responsibility and the definition of poverty were outlined in directive number 14 issued by the Office of Management and Budget. As participants in the poverty hearing held by this committee in October of last year, we presented information on several important issues regarding the U.S. poverty population.

First, our testimony summarized changes in the size and composition of the poverty population, focusing mainly on the significant increases in the number of persons officially classified as poor between 1979 and 1982.

Second, we presented findings from our research into methods for assigning monetary values to the noncash benefits received by the low-income population. This research showed that the value of these benefits—which include food stamps, public housing, school lunches, medicare and medicaid—is now about twice as large as the dollar value of cash assistance provided to the poor.

This research also showed that inclusion of the value of these benefits as income significantly lowers the estimates of the poverty

population. Finally, we provided to the committee estimates of the taxes paid by the poverty population.

Before I begin our presentation on the main topic of today's hearing, I would like to address your request for information concerning the experts being assembled to review our work on assigning monetary values to noncash benefits. In this regard we have selected eight economists who are knowledgeable about the various conceptual and empirical issues associated with evaluation of these benefits.

These experts will be acting as consultants to the Bureau and will perform a technical review of the procedures used to value noncash benefits in our two previous research efforts—technical papers 50 and 51—the results of which were released in March 1982 and February 1984.

They will be asked to make technical recommendations on the approaches that should be used in future work to value noncash benefits to the low-income population. They will also be asked to consider approaches for valuing fringe benefits received by middle- and upper-income households, such as employer contributions for pension and health plans. They will not be making any public policy decisions but will only be providing methodological and technical advice.

Today's hearings on the Federal tax treatment of low-income persons continues our discussion of estimates of the taxes paid by this group. The information that we have on this particular subject is, however, very limited because we have not conducted an in-depth analysis in this area.

The subject of these hearings can be subdivided into two distinct areas. The first area is the tax regulations themselves, how they apply to taxpayers with income below the poverty level and how they have changed over time. This information has appropriately been supplied best by an expert from the Department of the Treasury.

The second area is measurement of the effects of Federal taxes on the poverty population and how these effects have changed over time. Our recent work on estimating household income after taxes enables us to provide data on this subject.

It is relatively easy to describe the tax regulations that apply to the lower end of the income distribution. However, it is very difficult to precisely measure their effect. Data based on information compiled from tax returns cannot be used directly to measure these effects because all information needed to determine poverty status is not available from this source.

At the present time, we at the Bureau of the Census do not have information collected in any of our household surveys on both the amount of income received and the amount of taxes paid by the U.S. population. The current population survey, the source of official poverty estimates, obtains data on the amounts of cash income received annually before taxes but does not obtain information on taxes paid.

Even though we do not have information collected directly from our annual March income survey on taxes paid, we have been working on procedures to simulate the taxes paid by households

using before-tax income data and other household and persons characteristics recorded in the survey.

Simulations such as the one we have employed are commonly used by researchers. In our case we have essentially carried out on a statistical basis the process of filing a tax return for each sample household in our survey. This research project, initiated in 1980, was designed to produce estimates of after-tax income distributions to supplement our before-tax income measures, not for purposes of tax analysis.

The procedures that we have developed simulate Federal tax-filing units, compute adjusted gross income, calculate taxable income by simulating itemized and standard deductions and compute next tax liability using the appropriate tax schedules. The earned income tax credit, important for the low-income population, was also estimated.

In addition, State income taxes, social security, payroll taxes, and property taxes were simulated using various administrative and survey sources. The simulation model for estimated Federal taxes uses published statistical summaries based on Federal tax returns to assign the various tax filing characteristics but does not account for each and every facet of the tax regulations.

Simulations of the other types of taxes are based on other data sources but similarly do not address each aspect of the specified tax system. For these reasons, the estimate based on our procedures should be considered as rough approximations. We do feel, however, that the estimates based on our model are useful in assessing the general effect of taxes on the poverty population. This particular data source is especially important because it allows analysis of the distribution of after-tax income for specific subgroups of households below the poverty level.

The Bureau has compiled data on three subjects in which this committee has expressed interest. These are one, the proportion of households below the poverty level paying taxes; two, the average amounts of taxes paid; and three, the change in poverty resulting from the use of an after-tax income concept. We have information on these topics for calendar years 1974, 1980, and 1981. A report to be issued in July will update these estimates for calendar year 1982.

POVERTY HOUSEHOLDS PAYING TAXES

The first of these topics I would like to discuss concerns households below the poverty level paying Federal income and Social Security payroll taxes and the amounts paid. In 1974, the earliest year for which we have made estimates, about 5.8 percent of the 8.3 million households below the poverty level paid Federal income taxes.

By 1980, the number of poor households had increased to 11.0 million, but the proportion paying Federal taxes had declined to about 4.0 percent. Data for 1981, the latest year for which we have made estimates, indicate that a higher proportion, about 6.5 percent of the 11.7 million households paid Federal income taxes.

Changes in the relationship between the income tax threshold and the poverty thresholds appear to play a major role in this in-

crease. In 1981 the poverty threshold for a family of four exceeded the minimum taxable income for the first time since 1974. Also contributing to this increase was the recession occurring in 1981, a situation that caused an increase in the working poor, a group more likely subject to these taxes.

The incidence of Social Security payroll taxes is much greater than that of Federal income taxes for the poverty population. In 1974 and 1980 about 41 percent of the households below the poverty level paid Social Security payroll taxes. This figure was slightly higher, 42 percent, in 1981.

AMOUNTS OF TAXES PAID BY POVERTY HOUSEHOLDS

Our estimates show that the average amount of Federal income taxes paid by poverty households have increased slightly since 1974. In 1974, the average amount paid was about \$160. This compares to \$195 in 1980, and \$180 in 1981.

The average amount of Social Security payroll taxes paid by households below the poverty level is higher than that for Federal income taxes. In both 1974 and 1980 the average Social Security payroll tax was about \$250 for households paying these taxes. The comparable figure for 1981 was \$290.

Changes in the proportion of households paying taxes and in the amount of taxes paid by the poverty population during the 1974 to 1981 period could have been affected not only by changes in tax policy but also by changes in the types of income received and in the types of households below the poverty level.

There has been a significant increase in the proportion of the total income the poor derive from employment. We have found that in 1974 about 28 percent of the income received by the poor was in the form of earnings. In 1981, the proportion received from earnings rose to 40 percent. During this same period the proportion of poverty households with one or more earners remained at about 50 percent.

We did not find any major shifts in the composition of the poverty population during this period, although there were a few changes that may have affected the proportion of households below the poverty level paying taxes and the amounts paid.

Of note were the increase of from 17 to 22 percent in the proportion of poverty households in the 25- to 34-year age group, the decline from 31 to 27 percent in the proportion of households in the 65-year-old and over category, and the decline from 19 to 16 percent in the proportion of households with five or more members. The net effect of these differences on changes in the proportion of poverty households paying taxes has not been analyzed in detail.

ESTIMATES OF POVERTY AFTER TAXES

The last subject we would like to address today is another in which your committee has expressed specific interest—the extent to which poverty rates would increase if after-tax income were used instead of the before-tax concept currently in use.

We have tabulated estimates of poverty based on after-tax income concepts only for 1980. Two different after-tax poverty estimates have been made. The first accounts for Federal and State

income taxes; the second accounts for Federal and State income taxes and social security payroll taxes.

Based on the official before-tax concept, 11 million households, or 13.3 percent, were below the poverty level in 1980. Using the income measure that deducts Federal and State income taxes, we have estimated the poverty rate for 1980 to be only 0.2 percent higher, at 13.5 percent. If social security payroll taxes are also deducted, the estimated number of poor households in 1980 rises to 14.1 percent.

SUMMARY

This concludes our presentation for today. We would be happy to provide the committee with any additional information you may require.

I would like to mention that the new survey of income and program participation that began in October 1983 will collect information on taxes paid and provide our first estimates of data in this area based directly on survey questions. The first collection of tax information in this new survey will cover tax year 1984. We would be glad to return and share these figures with you when they become available.

Thank you.

[Attachments to the prepared statement follow:]

TABLE 1.—PERCENT DISTRIBUTION OF POVERTY HOUSEHOLDS, AND PERCENT OF POVERTY HOUSEHOLDS PAYING FEDERAL INCOME AND SOCIAL SECURITY PAYROLL TAXES: 1974 AND 1981

Characteristic	1974			1981		
	Total	Paying Federal taxes	Paying social security taxes	Total	Paying Federal taxes	Paying social security taxes
Total.....	100.0	5.8	40.9	100.0	6.5	42.0
Race and origin of householder:						
White.....	72.9	6.0	39.9	71.7	6.9	42.9
Black.....	25.8	5.1	42.7	25.8	5.2	39.1
Spanish origin.....	7.7	9.4	51.1	8.4	9.8	50.6
Type of household:						
Family households.....	59.5	7.1	54.4	60.3	7.3	55.5
Married-couple families:						
With no related children under 18.....	11.4	5.8	39.5	10.7	5.7	37.9
With related children under 18.....	19.4	12.0	77.6	19.8	12.5	77.9
Female householder, no husband present, with related children under 18.....	25.3	3.6	44.7	24.8	3.3	46.3
Nonfamily households.....	40.5	3.8	21.1	39.7	5.3	21.5
Age of householder:						
15 to 24 years.....	13.4	8.4	63.4	10.6	8.4	62.0
25 to 34 years.....	17.2	8.2	55.7	21.6	8.2	59.7
35 to 44 years.....	13.7	9.9	64.6	15.0	10.0	64.3
45 to 54 years.....	12.4	8.0	54.4	11.3	10.2	55.5
55 to 64 years.....	14.3	6.8	37.8	13.4	7.9	34.5
65 years and over.....	31.0	.3	10.0	28.2	.4	7.3
Number of earners:						
No earners.....	52.0	.3		53.1	.6	
1 earner.....	34.8	10.7	81.0	33.7	11.7	86.8
2 earners.....	10.3	15.2	95.7	10.5	16.2	96.2
3 earners or more.....	2.9	12.9	100.0	2.7	19.5	99.0
Size of households:						
1 person.....	39.7	3.7	20.4	38.2	5.1	20.0

TABLE 1.—PERCENT DISTRIBUTION OF POVERTY HOUSEHOLDS, AND PERCENT OF POVERTY HOUSEHOLDS PAYING FEDERAL INCOME AND SOCIAL SECURITY PAYROLL TAXES: 1974 AND 1981—Continued

Characteristic	1974			1981		
	Total	Paying Federal taxes	Paying social security taxes	Total	Paying Federal taxes	Paying social security taxes
2 persons.....	19.6	5.0	38.2	20.8	4.1	41.3
3 persons.....	11.5	6.0	55.3	13.2	2.7	53.5
4 persons.....	9.9	5.8	57.2	11.7	8.2	63.0
5 persons or more.....	19.3	10.7	69.1	16.1	14.8	70.4

Figure 1. Percent of Households Below the Poverty Level Paying Federal Income Taxes

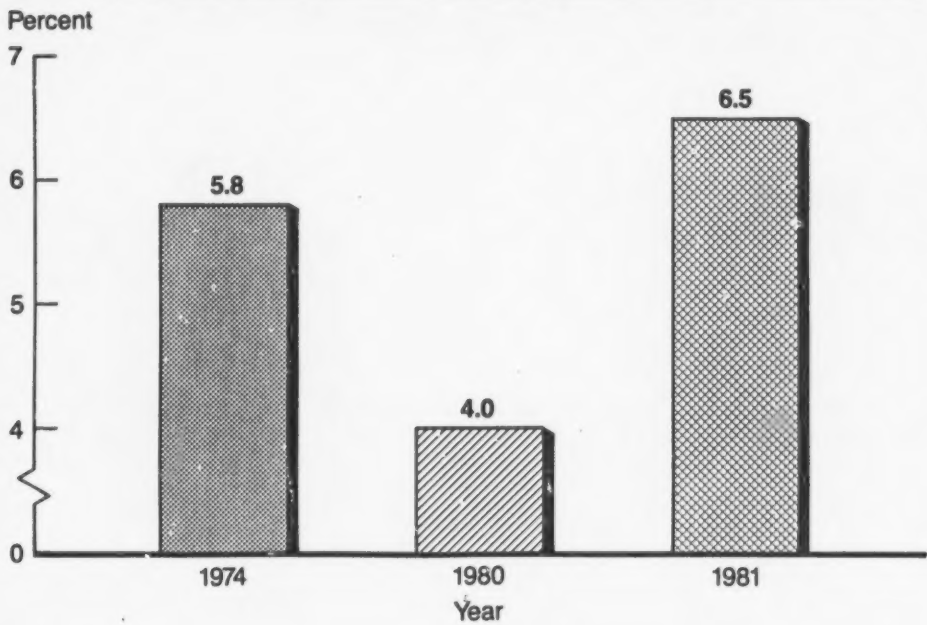


Figure 2. Percent of Households Below the Poverty Level Paying Social Security Payroll Taxes

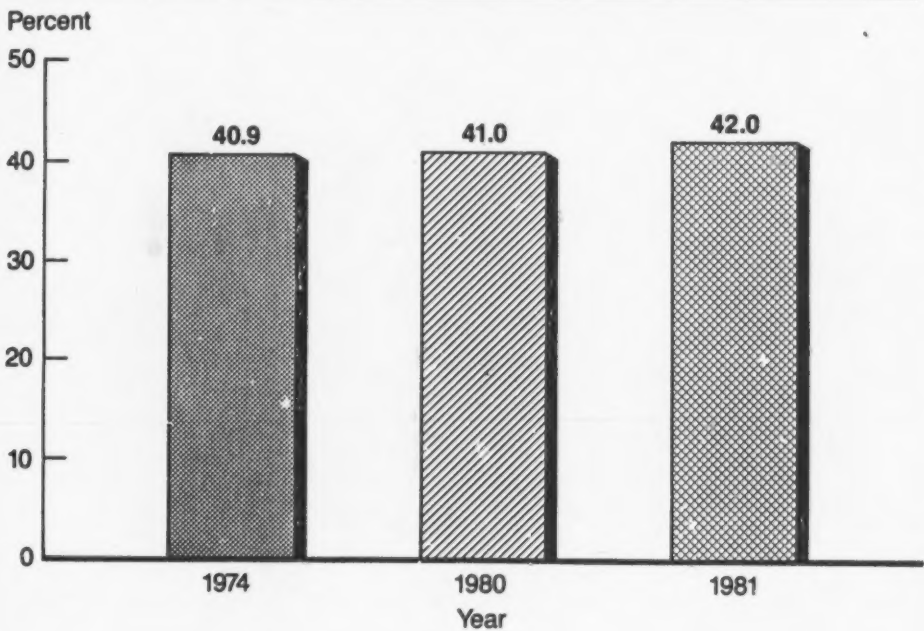


Figure 3. Mean Amount of Federal Income Taxes Paid by Households Below the Poverty Level

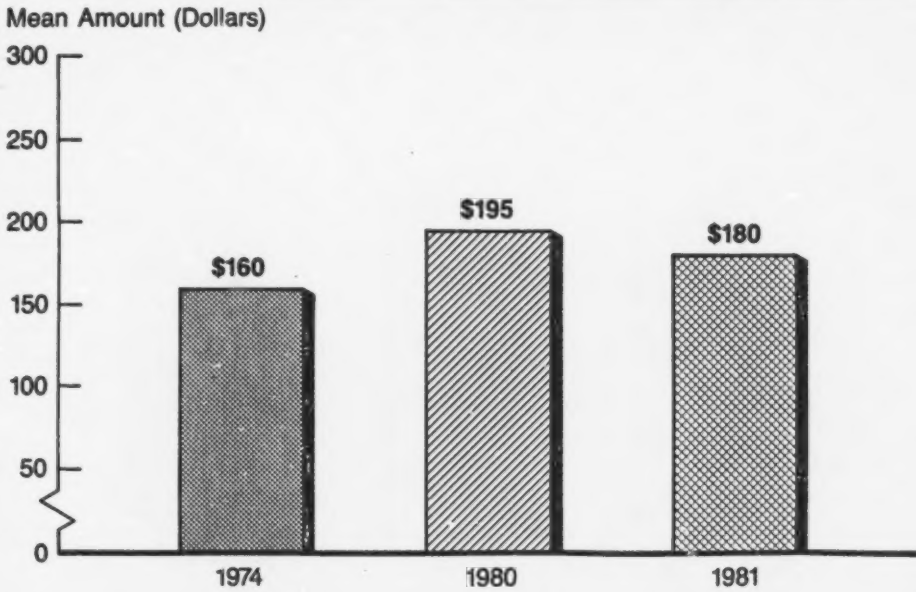


Figure 4. Mean Amount of Social Security Payroll Taxes Paid by Households Below the Poverty Level

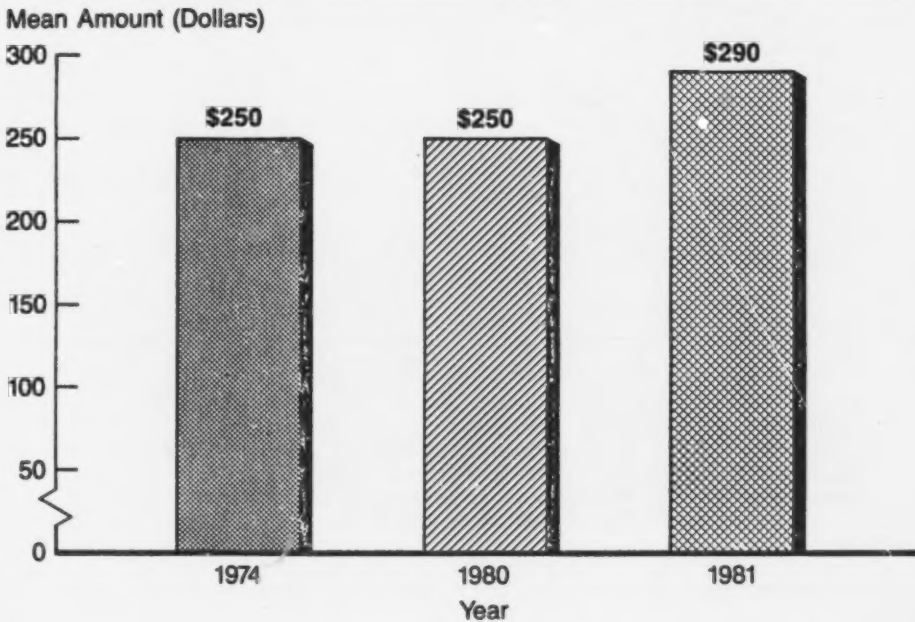
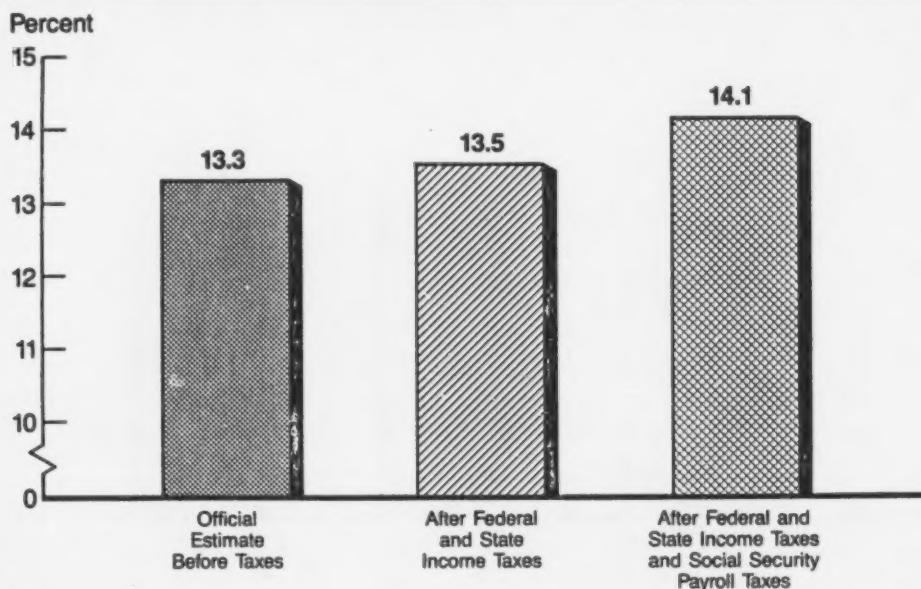


Figure 5. Percent of Households Below the Poverty Level Before and After Accounting for Specified Taxes: 1980



[Additional material subsequently received follow:]

COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC, April 19, 1984.

JOHN F. CODER,
Chief, Income Statistics Branch, Bureau of the Census, Washington, D.C.

DEAR DR. CODER: On behalf of the Subcommittee on Oversight, I wish to thank you for testifying on the federal tax treatment of low income individuals. Your statement was important in aiding the Subcommittee's inquiry into the recent increases in federal taxes on the poor.

Attached are several questions which we would like answered for the record. If the answers for 1982 cannot be prepared immediately, please submit the 1982 data at a later date.

Again, I very much appreciated your testimony.

Sincerely,

WILLIAM A. KIRK,
Staff Director.

Enclosure.

1. In actual numbers and as a percentage of the population, what are the number of individuals below poverty for each of the years from 1979 to 1982

(a) Under the official poverty definitions,

(b) Under a definition which subtracts federal and state income and federal payroll taxes from money income before comparison to the poverty thresholds,

(c) Under a definition which adds food stamps to money income,

(d) Under a definition which adds food stamps and housing benefits to money income, and

(e) Under a definition which adds food stamps and housing benefits to money income and subtracts federal and state income and federal payroll taxes from money income before comparison to the poverty threshold.

2. What is the number and percentage of family units and unrelated individuals below poverty who pay federal income taxes, state income taxes, federal payroll taxes, and property taxes and any tax for each of the years from 1979 to 1982.

3. What is the aggregate amount (and expressed as a percentage of money income) of taxes paid (separated by federal income, state income, federal payroll, property tax and total tax) for family limits and unrelated individuals.

TABLE 1.—NUMBER OF PERSONS BELOW THE POVERTY LEVEL AND POVERTY RATES BY SELECTED INCOME CONCEPTS: 1979 to 1982¹

[Numbers in thousands]

Income concept ²	Year			
	1982	1981	1980	1979
NUMBER				
Money income only	34,398	31,822	29,272	26,072
Money income and food stamps	32,952	30,238	27,421	24,035
Money income, food stamps, and public housing	31,599	28,748	25,934	22,490
Money income less Federal and State income taxes and payroll taxes....	37,573	35,118	31,561	28,014
Money income, food stamps, and public housing less Federal and State income taxes and payroll taxes	34,768	31,955	28,158	24,387
POVERTY RATE				
Money income only	15.0	14.0	13.0	11.7
Money income and food stamps	14.4	13.3	12.2	10.8
Money income, food stamps, and public housing	13.8	12.7	11.5	10.1
Money income less Federal and State income taxes and payroll taxes....	16.4	15.5	14.0	12.6
Money income, food stamps, and public housing less Federal and State income taxes and payroll taxes	15.2	14.1	12.5	10.9

¹ The data in this table were prepared at the request of Mr. William A. Kirk of the House Committee on Ways and Means, Subcommittee on Oversight, in his Apr. 19, 1984, letter.

² Estimates based on the market value of food stamps and public housing.

NA: Not available.

Source: Bureau of the Census; July 1984.

TABLE 1.—NUMBER AND PERCENT OF FAMILIES, UNRELATED INDIVIDUALS AND PERSONS BELOW THE POVERTY LEVEL: 1979 to 1981

[Numbers in thousands]

Year	Number			Percent		
	Families	Unrelated individuals	Persons	Families	Unrelated individuals	Persons
1979	5,461	5,743	26,072	9.2	21.9	11.7
1980	6,217	6,227	29,272	10.3	22.9	13.0
1981	6,851	6,490	31,822	11.2	23.4	14.0
1982	7,512	6,458	34,398	12.2	23.1	15.0

TABLE 2.—NUMBER AND PERCENT OF HOUSEHOLDS BELOW THE POVERTY LEVEL PAYING TAXES BY SPECIFIED TYPE OF TAX AND TYPE OF HOUSEHOLD: 1979 TO 1981

[Numbers in thousands]

Type of tax	Number				Percent			
	1982	1981	1980	1979	1982	1981	1980	1979
FAMILY HOUSEHOLDS								
Total	7,338	6,670	6,036	NA	100.0	100.0	100.0	100.0
Paying:								
One or more taxes	5,172	4,839	4,313	NA	70.5	72.5	71.5	NA
Federal income tax	515	486	251	167	7.0	7.3	4.2	3.1
State income tax	1,111	1,031	817	NA	15.1	15.5	13.5	NA
Payroll tax	3,965	3,703	3,276	2,833	54.0	55.5	54.3	53.1
Property tax	2,690	2,546	2,245	NA	36.6	38.2	37.2	NA

TABLE 2.—NUMBER AND PERCENT OF HOUSEHOLDS BELOW THE POVERTY LEVEL PAYING TAXES BY SPECIFIED TYPE OF TAX AND TYPE OF HOUSEHOLD: 1979 TO 1981—Continued

(Numbers in thousands)

Type of tax	Number				Percent			
	1982	1981	1980	1979	1982	1981	1980	1979
NONFAMILY HOUSEHOLDS								
Total.....	4,197	4,387	4,301	NA	100.0	100.00	100.0	100.0
Paying:								
One or more taxes.....	2,237	2,423	2,300	NA	53.3	55.2	53.5	NA
Federal income tax.....	334	231	165	99	8.0	5.3	3.8	2.5
State income tax.....	402	347	367	NA	9.6	7.9	8.5	NA
Payroll tax.....	958	941	866	829	22.8	21.5	20.1	20.8
Property tax.....	1,432	1,708	1,611	NA	34.1	38.9	37.5	NA

NA—Not available.

TABLE 3.—AGGREGATE AMOUNT OF TAXES AND PERCENT OF INCOME PAID IN TAXES BY TYPE OF TAX AND TYPE OF HOUSEHOLD: 1979 TO 1981

(Aggregate in millions of dollars)

Type of tax	Aggregate amount				Percent of income			
	1982	1981	1980	1979	1982	1981	1980	1979
FAMILY HOUSEHOLDS								
Total taxes.....	2,960.0	2,468.0	1,768.3	(NA)	8.0	7.6	6.6	NA
Federal income tax.....	117.2	105.0	60.7	31.5	0.3	0.3	0.2	0.1
State income tax.....	67.2	60.9	45.1	NA	0.2	0.2	0.2	NA
Payroll tax.....	1,287.7	1,193.8	833.3	636.8	3.5	3.7	3.1	3.0
Property tax.....	1,466.7	1,091.2	813.2	NA	4.0	3.3	3.0	NA
NONFAMILY HOUSEHOLDS								
Total taxes.....	813.2	771.2	583.4	NA	6.4	6.1	5.1	NA
Federal income tax.....	41.0	24.4	12.9	3.6	0.3	0.2	0.1	—
State income tax.....	18.0	13.7	13.8	NA	0.1	0.1	0.1	NA
Payroll tax.....	157.1	141.4	107.7	92.1	1.2	1.1	0.9	1.0
Property tax.....	593.9	590.8	446.1	NA	4.7	4.7	3.9	NA

NA—Not available.

— Less than 0.1 percent.

U.S. DEPARTMENT OF COMMERCE,
BUREAU OF THE CENSUS,
Washington, DC, April 23, 1984.

Hon. CHARLES B. RANGEL,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, Washington, DC.

DEAR MR. RANGEL: This is in response to the questions raised by the Committee at our hearing on April 12 concerning the mission of consultants who will review the Census Bureau's work on valuing noncash benefits.

The Bureau will ask the consultants to review our past work on valuing noncash benefits and to make recommendations on the best valuation approaches to be used in future work. We undertook to value noncash income at the direction of the U.S. Senate in 1980. We will not ask the consultants to recommend any changes to the poverty thresholds because the Bureau does not have the authority to change the definition of poverty. We will, however, ask the consultants if they think it is appropriate to compare income including noncash benefits against the official poverty thresholds, which are based on money income only.

We would prefer to use after-tax income rather than before-tax income to determine poverty status, but there are some complicating considerations. The multiplier used to derive the official poverty thresholds is based on the amount of food expenditures as a proportion of income after the payment of Federal and state income taxes. We have not been able to compute after-tax income in this manner until very

recently because our survey data are restricted to before-tax income. With the availability of our new tax simulation model, we have the ability to calculate after-tax income, but only with a considerable lag. Our model requires information on tax data from the Internal Revenue Service, which is not received until 6 months or longer after the survey data are available. Incorporating after-tax income in the determination of poverty status would delay significantly the release of our poverty estimates. We therefore do not intend to incorporate this change now. In any case, as we reported at the hearing on April 12, the use of income after payment of Federal and state income taxes would increase the poverty rate by only two-tenths of 1 percent.

We appreciate the interest of Congress in these important matters, and we will inform you at the earliest possible date about the analysis and recommendations of our consultants. We will ask the consultants to submit a written report to the Bureau detailing their technical recommendations on the various issues that have been raised. This report will be made available to the public.

Sincerely,

JOHN G. KEANE,
Director, Bureau of the Census.

Chairman RANGEL. Thank you.

I think you testified that the poverty rate for households has increased from 13.3 to 14.1 percent when taxes are taken into account. What would the number be of additional individuals that would be classified as poor if we took the Federal, State, and payroll taxes and subtracted that from income? How many individuals would be classified as poor?

Mr. CODER. The figures that you just quoted are precisely that. In 1980, 13.3 percent were officially classified as poor using the cash income concept. If we deduct Federal and State taxes, that rises to 13.5 percent. If we also deduct Social Security payroll taxes, it increases to 14.1 percent for that particular year.

Chairman RANGEL. And would you be able to supply for the record what the aggregate amount of taxes paid by families in 1981 below poverty for Federal income taxes and for payroll taxes? Could you give us that information for the record?

Mr. CODER. Yes.

Chairman RANGEL. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman. Thank you for your testimony this morning.

I am particularly interested in your comments regarding the panel of experts that will be discussing the measurement evaluation of in-kind benefits. I have been following that to the extent that I am able to, and I understand you have appointed a number of different economists from all over the United States. In California, for example, you picked Mr. Fuchs from Stanford University.

I would like to know how your selection occurred on these economists. Obviously you had a role in the selection of them; is this correct?

Mr. CODER. Yes. Gordon Green was more closely involved with that process and he would be a better person to answer it.

Mr. MATSUI. Yes; please go ahead. You did have a role in the selection of these economists?

Mr. GREEN. Yes; the Census Bureau did have a role. We tried to select people who were very knowledgeable about the evaluation procedures that we used. I think each of the eight economists that we picked has a particular area of expertise that would be very valuable to us.

Mr. MATSUI. I know you probably did not have anything like a USIA list, but with the exception of one that I have seen on this list—and I will not mention him—but they all appear to be legitimate and carefully thought out. But I understand also that OMB did have a role in the selection as well as Census. Is this correct?

Mr. GREEN. We did confer with OMB in selecting these experts.

Mr. MATSUI. And they were also involved and that is probably why you are a little to the right of center in terms of direction and philosophy of these economists through the OMB selection process.

Mr. GREEN. Well, I think the major criteria was to pick people who were technical experts. We would view this as a technical review.

Mr. MATSUI. There are others in the stream or in the pot, as we know, and you selected these. What methodology did you use in the selection process?

Mr. GREEN. Well, for example, we were very concerned about the evaluation of the medical benefits, which is really the most problematic part of this whole thing.

Mr. MATSUI. Is this the theory Stockman used last year, that the sicker you get the more money you make and therefore you are over the poverty level? Go right ahead. That is just an editorial comment on my part.

Mr. GREEN. We have never been guilty of that. We have always used an insurance value approach. But the medical care is still very problematic because the insurance value of some of these medical benefits is so large as to raise some people completely above the poverty line in certain States, even if they have no other sources of income.

And in fact we picked Mr. Fuchs because he is considered an expert in the medical area and we feel that needs a lot of investigation.

Mr. MATSUI. Well, let me get on to the information itself. You indicated in addition to the study of the measurement evaluation of in-kind benefits, in particular the medical benefits, that you will be discussing the effect of fringe benefits on middle income and lower income people as well. Is that correct?

Mr. GREEN. That is correct.

Mr. MATSUI. That appears to me to be somewhat of an expansion of the original study.

Mr. GREEN. Well, that is true. The Census Bureau has been collecting information on the reciprocity of certain fringe benefits such as employer contributions to pension plans, but we have not collected any data on the value of those benefits. In fact, many of our survey respondents would not really have all of the details about what the employers contribute.

Mr. MATSUI. Go ahead. I am sorry.

Mr. GREEN. But we feel that in looking at the effect of noncash benefits on the income distribution that it is very important to bring that into account because so far we have only counted the benefits received primarily by the low income population and that gives a negative skew to the income distribution.

But this is a much tougher area methodologically because the fringe benefits can be received in so many different forms, whereas

with Government programs you are at least dealing with some uniform criteria.

Mr. MATSUI. I appreciate the fact that you are expanding it because I think we want to get a true reflection of what the various income groups are receiving so Republicans and Democrats, conservatives and liberals will really be in a position to evaluate what is poverty and what is not poverty in the United States. So I commend you for that.

Apparently your mandate does allow you then to expand your study in order to develop the information so it becomes useful to the Congress. It appears to me that in view of the fact that we have increased since 1978 the income tax and payroll tax burden on low-income people, these changes should be reviewed. For example, that family of four that makes \$10,000 or less about which I asked Dr. McLure: In 1978 they paid \$269 for both payroll taxes and income taxes, and in 1985 it is projected that they will be paying \$1,166 in combined payroll and income taxes, some substantial increase, even though their salary is still \$10,000.

It appears to me that in order to really do the kind of job that I think this subcommittee and probably the Members of Congress will think is necessary to understand and analyze your study of both the fringe benefits and also the in-kind measurement evaluation that we should also study the effect of the payroll tax and income tax increases on this group of people as well.

Would you be kind enough to respond to that, and could you increase your direction and include this part of the study as well?

Mr. GREEN. We do issue a report every year on after-tax income and we do show the proportion of the poor paying taxes and the amount they are paying. In fact, in July we will issue that report for 1982.

Mr. MATSUI. That is great, then.

Chairman RANGEL. Would the gentleman yield?

Mr. MATSUI. Yes.

Chairman RANGEL. Could all of this be pulled together, I mean in addition to your regular report? Could you have that included in the report that examines poverty?

Mr. GREEN. Well, we will certainly have a section in the report discussing taxes for the poor. Now do you mean to pull from the various reports to give a separate report to the committee?

Chairman RANGEL. To have a more comprehensive report.

Mr. GREEN. Yes.

Mr. MATSUI. What I would like is to have these economists, these distinguished economists, include in their study this payroll tax and income tax increase and make it part of their study because I think if you deal with the medical benefit valuation issue the fringe benefit issue and exclude the fact that income taxes have gone up some 500 percent since 1978 and the payroll taxes you still may have this distortion effect.

And so if you could put all of that in there and have them evaluate the effect of the payroll and income taxes I think that we could look at your study and really it might be something that we could really use and I would like to see that done and I hope you can tell me today at this moment that you would be willing to include that.

Mr. GREEN. Well, I will pass that request forward to the Bureau. I know that you certainly have to look at tax issues when you are looking at fringe benefits.

Mr. MATSUI. And because you are doing this study anyway it would make it a lot easier. In other words, we are not asking you to spend a lot of money to do this, that it would just be collating the information giving it to this panel of experts and asking them to evaluate that variable in addition to those other variables.

Chairman RANGEL. You might include that as a formal request from the Chair, not that I think you would have any problem with it and need anything in writing, but you do such great work and if you can just include what we need for us to make our concrete policy it would be helpful.

Mr. MATSUI. And if you decide you cannot do it I hope you will let us know within a week so that we will be in a position to maybe call you back at the same time we call Dr. McLure.

Second, I understand that because this is a group of consultants to the Census Bureau that there really will not be any public input or opportunity for the public to really respond. Is this correct?

Mr. GREEN. That is correct.

Mr. MATSUI. And the meeting will be a closed meeting, a private meeting in which there will be no opportunity for the press and the public to be involved at all; is that right?

Mr. GREEN. That is correct. It is as any technical meeting with consultants.

Mr. MATSUI. Well, I cannot complain about that, but it is my hope that the methodology and some of the views of those that were in the meeting will also be available to the Members and the public that will be interested in this issue so that we will know why these results were decided on and we will know if there is any dissention or if there were any contrary points of view.

I am very interested in this issue because I followed it when Mr. Stockman testified last year. I intend to follow it through and certainly hope that it will be the scholarly type of work that I know you expect it to be.

Thank you, and I would like to thank the two of you gentlemen for testifying here today, and we appreciate your time very much.

At this time we will call Mr. Joseph Minarik, senior research associate of the Urban Institute, and Robert Greenstein, the director of the Center on Budget and Policy Priorities.

Chairman RANGEL. Thank you very much. Now we have Dr. Joseph Minarik, senior research associate of the Urban Institute and again we have your testimony and it will be entered into the record in full and you could summarize it if you like. And I also would like to take this opportunity, before I forget to ask, whether or not you will continuously work with the subcommittee as we try to formulate some tax policy that would alleviate the gap that we have with the poor and the working poor.

You may proceed, Doctor. I would also like to welcome Mr. Robert Greenstein, director of the Center on Budget and Policy Priorities, and we welcome the work that you have done. You may proceed.

**STATEMENT OF JOSEPH J. MINARIK, SENIOR RESEARCH
ASSOCIATE, THE URBAN INSTITUTE**

Mr. MINARIK. Mr. Chairman, I appreciate the opportunity to testify before this subcommittee on the subject of Federal tax policy on property in the United States. At the outset, I would like to emphasize that the opinions expressed in my testimony are my own and should not be attributed to the Urban Institute, its officers, trustees, or other staff members.

Chairman RANGEL. Can we attribute them to you?

Mr. MINARIK. I do not want to shake up the hearing too much, sir, but these are my opinions. [General laughter.]

In the interests of time, let me direct you to the table that follows page 4, and I will read through a part of my testimony that bears directly on that table. The early part of the testimony discusses pretty much the same background as was raised in the joint committee document, and mentions how inflation has eroded the ZBA, the personal exemption, and the earned income tax credit. I tried to look at the numbers a little bit differently, and table 1 of the testimony measures the effect of low-income relief provisions and inflation on poor and near-poor families over the last 20 years. The table shows the tax paid as a percentage of income by hypothetical husband and wife families with two children and all of their income from the earnings of one spouse. For comparability, over the years, income is denominated in units of from 80 percent to 150 percent of the appropriate poverty threshold for each year.

The first 2 years presented are 1963, which is the last tax year before the Kennedy-Johnson tax cut, and 1965, which is the first year in which that tax cut was fully in effect. The table shows that the establishment of the minimum standard deduction in combination with reduced tax rates significantly reduced the tax burden on the poor and near-poor at that time. Of course, the earned income credit was not yet part of the code, and so taxes were never reduced below zero.

The earned income credit was introduced in 1975 along with further increases in the minimum standard deduction, plus an exemption credit to supplement the personal exemption. With these tax provisions, even families with incomes 20 percent above the poverty line paid negative income taxes, and those further up the income scale had their liabilities substantially reduced.

The year 1975 proved to be the high water mark of progress against tax burdens on the poor. By 1980, the last year before the 1981 tax cuts took effect, the borderline poor families' net negative income tax had just about disappeared, and taxes over the entire range shown in the table were higher than in 1975 because of the cumulative 53-percent inflation over those years.

The 1981 tax cuts are now fully phased in. They provide lower tax rates at all taxable income levels but did not increase the personal exemptions, the ZBA, or the earned income tax credit, and of course, it is these provisions that protect the poor from taxation. The tax rate cuts merely moderate the burden once the poor are inflated onto the tax rolls.

The table documents the failure of the 1981 law to deal with this issue. Families at 90 percent of the poverty level are paying income

taxes for the first time in 10 years. Taxes all up and down the scale are higher than they were in 1980. In fact, apart from the very low-income levels where negative taxes are still paid, the poor and near-poor now pay larger fractions of their income in tax than they paid in 1965, immediately after the Kennedy tax cuts. Indeed, from 90 to 110 percent of the poverty line, effective tax rates are now higher than they were in 1963, before the Kennedy tax cuts.

Table 2, following page 5, presents analogous computations for a single female parent family of three, and the results are fairly similar.

Table 3, following page 6, shows the same computations for a single male, and although the level of taxes that single people must pay is higher, again, the pattern over time remains the same.

Now, the evidence here suggests that the erosion of low-income relief that we have seen has been serious. It has set tax policy back nearly 20 years. Further, that erosion has occurred across the board, affecting all types of low-income households. It is evident that the 1981 tax cuts failed to preserve the low-income relief in the tax system. This failure occurred on all three fronts, the personal exemptions, the zero bracket amounts, and the earned income credit. Of the three, the earned income credit seems to have received the most attention. Nonetheless, the zero bracket amount and the exemptions cannot be ignored, especially because the earned income credit does not benefit childless couples or single persons.

The 1981 act indexes the personal exemptions and ZBA, beginning in calendar year 1985, but such indexation should not be construed as a remedy for the erosion of low-income relief shown in these tables. Indexation will provide relief only for future inflation. It will not compensate for the effects of the estimated 60-percent inflation over 1978 through 1984. Further, indexation does not apply to the earned income tax credit. Though indexation of all low-income relief provisions might be seen as a remedy for future inflation, such a contention requires examination. Indexation has possible drawbacks in terms of economic stabilization and the control of inflation.

What is needed at a minimum, however, is a consciousness of the impact of tax provisions on low-income households. The development of such a consciousness is a valuable function that these hearings can perform.

While the evidence suggests several targeted policy steps that can be taken in the short run to reduce the tax burden on the poor, it also supports a new approach to overall income tax design very much like the Treasury's fundamental reform study.

I would like to ask the subcommittee's indulgence to raise this question for just a moment. A familiar concept in antipoverty cash transfer programs is target efficiency, the degree to which a program concentrates its benefits on those who most need help. While this term is seldom used in tax policy, there is no reason why it shouldn't be. In fact, in the current context, it could prove quite useful.

There are several provisions of the current income tax that are designed to provide relief to low- and moderate-income taxpayers but whose overall effect can be quite different.

One example that I mentioned earlier in the testimony is the additional exemption for elderly taxpayers. The additional exemption can be seen as relief for single elderly persons whose exemptions and zero bracket amounts are too low to exempt a poverty level income. With a steeply graduated rate schedule, however, the additional exemption can have quite different effects.

In 1981, the latest year for which data are available, there were 5,286 tax returns with at least \$1 million of adjusted gross income. Of these, 1,815, that is, over one-third, claimed at least one additional exemption for age. In all, 2,659 additional exemptions were claimed on these returns. In effect, the Federal Government ran a \$1,329,500 program of direct cash grants to elderly millionaires. Yet few people were aware that such a program existed, or would even know where to look for it.

Another example of such misdirection in policy is the provision of low-income relief to single people in general. As was noted earlier in the testimony, the exemptions and ZBA do not protect many poor single persons from income taxation because of a fear that such relief would be lost on young people who are in fact dependent on their parents and whose own income therefore understates their true standard of living. Under the current tax law, the low-income relief and the graduated tax rates can be used by parents who transfer wealth to their children during life to reduce the tax on the income that such wealth generates.

Many would not want to eliminate the extra exemption for the elderly because of its function of reducing the tax burden on the financially vulnerable moderate income elderly, among other reasons, and we cannot eliminate the low tax rates in the first few brackets for single persons just to prevent tax minimization by a few wealthy families. But we could make the additional exemption for the elderly and the graduated rates more target efficient by simplifying the tax code, eliminating many of the preferential legal provisions that provide selective relief to taxpayers at all income levels, and adopting a lower tax rate schedule.

For example, the additional \$1,000 exemption for the elderly reduces tax by \$110 for those in the lowest tax bracket but by \$500 for those in the highest tax bracket, like the millionaires discussed earlier. A system that limited exemptions to reducing tax in a 14-percent bottom tax bracket would save all elderly persons \$140. This would reduce the overall cost of the extra exemption and target the revenue loss on those most in need. Likewise, a system that cut the spread of tax rates to a 14- to 30-percent range would substantially reduce the reward to taxpayers who now manage to transfer income from family members in the 50-percent bracket to others at the 11-percent rate.

A number of proposals for fundamental tax restructuring have surfaced recently from both congressional Democrats and Republicans. The administration has also expressed an interest with a report from the Treasury due shortly after the November elections. It is worth remembering that such proposals would have a payoff in the tax treatment of the poor by directing more relief where it is needed most.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF JOSEPH J. MINARIK*

I appreciate the opportunity to testify before this Subcommittee on the subject of federal tax policy and poverty in the United States. At the outset, I would like to emphasize that opinions expressed in my testimony are my own, and should not be attributed to The Urban Institute, its officers, trustees, or other staff members.

BACKGROUND AND HISTORY

As the background materials for earlier hearings explain, the federal individual income tax has been changed several times to reduce the tax burden on the poor and the near-poor. The reason is quite straightforward: there is a widespread conviction that those whose incomes are near the subsistence level should not be made less well off by the federal income tax. Despite the clear rationale for this approach, it has been challenged on occasion. Some people have argued that every citizen should pay at least some nominal income tax as a part of the responsibility of a member of a democratic society. While this argument has some appeal, it has not carried the day for at least two reasons. First, although poor people may be excluded from the federal income tax, they still may pay other taxes, including the Social Security payroll tax, federal excise taxes, and state and local sales taxes. And second, requiring persons with very low incomes to file and pay federal income taxes would involve substantial compliance and administrative costs to collect very little revenue.

The consensus objective to lift the federal income tax burden from the poor has been pursued in three ways. First, personal exemptions are provided for each taxpayer and dependent; under current law, the exemption is \$1,000. The personal exemption has been increased several times, most recently in the Revenue Act of 1978. In the mid-1970s the Congress experimented with an exemption credit to supplement the personal exemption, but the 1978 Act returned to a straightforward exemption. The combination of an exemption and a credit complicated the law beyond any possible benefit.

The second means of providing low income relief is the standard deduction, or as it is now called, the "zero bracket amount." The standard deduction, or as it is now called, the "zero bracket amount." The standard deduction allowed by the Internal Revenue Code of 1954 was equal to the lesser of 10 percent of income or \$1,000, making it very small for low-income taxpayers. The concept was liberalized substantially in the Revenue Act of 1964 through the establishment of a minimum standard deduction, giving even low-income persons significant relief (originally \$200 plus \$100 for each exemption claimed). Since 1964, the minimum standard deduction was increased and simplified, until in 1977 a fixed dollar zero bracket amount was made available to all taxpayers (currently \$3,400 for married couples and \$2,300 for other taxpayers). The larger zero bracket amount has the advantage of allowing significant tax relief without requiring taxpayers to bear the paperwork burden of itemizing their deductions. Further, the relief is focused on low- and moderate-income taxpayers, because those with higher incomes generally choose to itemize.

The third avenue of low-income relief is the refundable earned income tax credit, enacted in the Tax Reduction Act of 1975. This tax credit is available only to taxpayers with dependent children, and is equal to 10 percent of their labor income up to a ceiling (currently \$5,000 of income, for a \$500 credit), with the credit gradually phased down as income increases (the credit currently vanishes at \$10,000 of income). The earned income credit was justified partially as general low-income relief, and partially as an implicit refund of the Social Security payroll tax liability that even low-income workers must bear. The excess of the earned income credit over tax otherwise due is payable to the taxpayer in cash, and a relatively complex mechanism for distributing the credit to taxpayers with each paycheck rather than as an end-of-year tax refund has been established.

The net effect of these three provisions has been to remove, or at least to reduce, the tax burden on poor and near-poor families in most recent years. In 1964, even before the introduction of the earned income tax credit and at the very advent of the poverty concept, the first minimum standard deduction substantially cut the tax liability of poor families. In 1975, the earned income credit established a new precedent for negative income taxes (to offset positive payroll taxes) on poor families. Subsequent increases in the minimum standard deduction and the earned income credit further reduced this tax burden. There is ample evidence of Congressional

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awareness of the relationship between these tax system parameters and the official poverty thresholds, and of Congressional intent to remove the poor from the tax rolls whenever possible.

The only exception to this long-term development has been the tax treatment of single people. The earned income credit was denied to single people (and couples without children), and the exemption and standard deduction for single people has never been sufficient to remove those at the poverty threshold from taxation. This path has been chosen because many single taxpayers are in fact young people, including students, who are partially or fully dependent upon others and whose own income understates their true standard of living; and because other low-income taxpayers are elderly and have additional income from Social Security that need not be reported on tax returns. To protect these elderly from excessive taxation, the law grants them an additional personal exemption upon reaching the age of 65.

Recent developments

This strategy of reducing the tax burden on the poor can be negated by inflation. The personal exemption, zero bracket amount and earned income credit are all denominated in nominal dollars. A person who is on the border of taxability, and whose income just keeps up with a rapid inflation, will become taxable and thus bear a tax burden for the first time. Because the bottom bracket tax rates are quite low, this newly borne tax burden will be small in dollar terms; but for those who are living at a subsistence level, where every dollar counts, even such a small burden can weigh heavily. The concern over this issue is largely the result of the rapid inflation that has occurred since the last adjustment of the exemptions, zero brackets, and the earned income credit in 1978.

The evidence

Table 1 of this testimony measures the effect of the low income relief provisions, and inflation, on poor and near-poor families over the last twenty years. The table shows the tax paid as a percentage of income by hypothetical husband-wife families with two children and all of their income from the earnings of one spouse. For comparability over the years, income is denominated in units of 80 percent to 150 percent of the appropriate poverty threshold for each year.

The first two years presented are 1963 (the last tax year before the Kennedy-Johnson tax cut) and 1965 (the first year in which that tax cut was fully effective). The table shows that the establishment of the minimum standard deduction, in combination with reduced tax rates, significantly reduced the tax burden on the poor and near-poor. Of course, the earned income credit was not yet part of the code, and so taxes were never reduced below zero.

TABLE 1.—TAX BURDENS ON POOR AND NEAR-POOR (PERCENT), HUSBAND-WIFE FAMILIES OF 4, SELECTED YEARS

Year	Income as a percentage of poverty threshold							
	80	90	100	110	120	130	140	150
1963.....	0	0.82	2.54	3.94	5.11	6.10	6.95	7.69
1965.....	0	0	.87	2.06	3.06	3.94	4.73	5.41
1975.....	-8.33	-6.29	-4.66	-2.74	-43	1.56	3.30	4.62
1980.....	-6.20	-3.90	-.86	1.62	3.77	4.71	5.53	6.36
1984.....	-.97	1.75	3.38	4.16	4.98	5.68	6.27	6.79

Source: Computed by the author.

Note: Assumes a nonfarm family of 4 with husband and wife under age 65 and 2 children under age 18, with all income earned as wages by 1 spouse, and tax returns claiming the standard deduction or zero bracket amount.

The earned income credit was introduced in 1975 along with further increases in the minimum standard deduction (plus an exemption credit to supplement the personal exemption). With these tax provisions, even families with incomes 20 percent above the poverty line paid net negative income taxes, and those further up the income scale had their liabilities substantially reduced.

The year 1975 proved to be the high water mark of progress against tax burdens on the poor. By 1980, the last year before the 1981 tax cuts took effect, the borderline-poor family's net negative income tax has just about disappeared, and taxes over the entire range shown in the table were higher than in 1975, because of the cumulative 53 percent inflation over those years.

The 1981 tax cuts are now fully phased in. They provide lower tax rates at all taxable income levels, but did not increase the personal exemptions, the zero bracket amounts, or the earned income tax credit. Of course, it is these provisions that protect the poor from taxation; the tax rate cuts merely moderate the burden once the poor are inflated onto the tax rolls. The table documents the failure of the 1981 law to deal with this issue. Families at 90 percent of the poverty level are paying income taxes for the first time in ten years. Taxes all up and down the scale are higher than they were in 1980. In fact, apart from the very low income levels where negative taxes are still paid, the poor and near-poor now pay larger fractions of their income in tax than they paid in 1965, immediately after the Kennedy tax cuts. Indeed, from 90 to 110 percent of the poverty line, effective tax rates are now higher than they were in 1963, before the Kennedy tax cuts.

Table 2 presents analogous computations for a single-female-parent family of three. The result is similar. Taxes in recent years have been lower for single-parent families near the poverty line, simply because their poverty line is lower, and therefore closer to the level where the earned income credit is at its maximum. Tax burdens on poor female-headed families were at their lowest in 1975, increased through 1980, and were not reduced by the 1981 tax cuts. By 1984 female-headed families of three at the poverty line paid income taxes for the first time since 1974; from the poverty level on up the tax burdens exceed those of the post-Kennedy tax cut year of 1965.

TABLE 2.—TAX BURDENS ON POOR AND NEAR-POOR (PERCENT), FEMALE-HEADED FAMILIES OF 3, SELECTED YEARS

Year	Income as a percentage of poverty threshold							
	80	90	100	110	120	130	140	150
1963.....	0	1.67	3.31	4.64	5.76	6.70	7.50	8.20
1965.....	0	0	1.25	2.41	3.37	4.19	5.02	5.76
1975.....	-10.00	-10.00	-8.57	-6.16	-3.53	-1.25	.75	2.57
1980.....	-9.48	-6.93	-3.71	-.96	1.46	3.54	5.32	6.94
1984.....	-4.03	-.96	1.59	3.67	5.50	6.17	6.73	7.40

Source: Computed by the author.

Note: Assumes a nonfarm female-headed family of 3 with head under 65 and 2 children under age 18, with all income earned as wages, and tax returns claiming the standard deduction or zero bracket amount.

Table 3 shows the same computations for a single male. Although the level of taxes that single people must pay is higher, in large part because of ineligibility for the earned income credit, the pattern of changes over time is for the most part similar to that for families. There is more evidence of increasing tax relief for single people over the long haul, however, largely because the minimum standard deduction has increased more in percentage terms for poor and near-poor single persons than it has for families.

TABLE 3.—TAX BURDENS ON POOR AND NEAR-POOR (PERCENT), SINGLE PERSONS, SELECTED YEARS

Year	Income as a percentage of poverty threshold							
	80	90	100	110	120	130	140	150
1963.....	8.91	9.92	10.73	11.39	11.94	12.41	12.81	13.15
1965.....	4.74	5.86	6.77	7.52	8.21	8.81	9.32	9.83
1975.....	0	.25	1.65	2.86	3.91	4.84	5.69	6.45
1980.....	1.00	2.45	3.62	4.75	5.68	6.61	7.42	8.13
1984.....	2.93	3.94	4.82	5.65	6.35	6.94	7.49	7.99

Source: Computed by the author.

Note: Assumes a non-farm single male under age 65, with all income earned as wages, and tax returns claiming the standard deduction or zero bracket amount.

Historical conclusions

The evidence suggests that the erosion of low-income relief has been serious; it has set tax policy back nearly twenty years. Further, that erosion has occurred across the board, affecting all types of low income taxpayers.

The data also show a clear contrast between the distributional effects of the Kennedy tax cuts and the tax cuts of 1981. The Kennedy tax cuts reduced the tax burden on the poor and near-poor; the 1981 tax cuts passively allowed that burden to increase. These data are easily verified with reference to the policy steps in the two tax laws. The Kennedy law coupled rate reductions with the establishment of the minimum standard deduction, which favored low-income taxpayers; the 1981 law joined rate cuts with other provisions that favored the more well-off, such as the expansion of IRA accounts, the deduction for two-earner couples, and the forthcoming exclusion for net interest income. While the 1981 tax cuts were approximately proportional by income group, estimates made by the Joint Committee on Internal Revenue Taxation in 1964 show that the Kennedy tax cuts reduced liabilities by 39.0 percent for taxpayers with under \$3,000 of income, 26.9 percent for those with \$3,000 to \$5,000 of income, and 20.6 percent for the \$5,000 to \$10,000 income group, in contrast to the average for the population as a whole of 19.4 percent.

Policy conclusions

Again, it is evident that the 1981 tax cuts failed to preserve the low income relief in the tax system. This failure occurred on all three fronts: the personal exemptions, the zero bracket amounts, and the earned income credit. Of the three, the earned income credit seems to have received the most attention. Nonetheless, the zero bracket amount and the exemptions cannot be ignored, especially because the earned income credit does not benefit childless couples or single persons.

The 1981 act indexes the personal exemptions and zero bracket amounts beginning in calendar year 1985, but such indexation should not be construed as a remedy for the erosion of low income relief shown in the tables. Indexation will provide relief only for future inflation; it will not compensate for the effects of the estimated 60 percent inflation over 1978-84. Further, indexation does not apply to the earned income tax credit.

Though indexation of all low-income relief provisions might be seen as a remedy for future inflation, such a contention requires examination. Indexation has possible drawbacks in terms of economic stabilization and the control of inflation. What is needed at a minimum, however, is a consciousness of the impact of tax provisions on low income households. The development of such a consciousness is a valuable function that these hearings can perform.

General conclusions

While the evidence suggests several targeted policy steps to reduce the tax burden on the poor, it also supports a new approach to overall income tax design. I would like to ask the Subcommittee's indulgence to raise this question for just a moment.

A familiar concept in anti-poverty cash transfer programs is target efficiency: the degree to which a program concentrates its benefits on those who most need help. While this term is seldom used in tax policy, there is no reason why it shouldn't be. In fact, in the current context, it could prove quite useful.

There are several provisions of the current income tax that are designed to provide relief to low- or moderate-income taxpayers, but whose overall effect can be quite different. One example mentioned earlier is the additional exemption for elderly taxpayers. As was noted, the additional exemption can be seen as relief for single elderly persons whose exemptions and zero bracket amounts are too low to exempt a poverty-level income. With a steeply graduated rate schedule, however, the additional exemption can have quite different effects. In 1981, the latest year for which data are available, there were 5286 tax returns with at least \$1 million of adjusted gross income; of these, 1815 (34.3 percent) claimed at least one additional exemption for age. In all, 2659 additional exemptions were claimed on these returns. In effect, the federal government ran a \$1,329,500 program of direct cash grants to elderly millionaires. Yet few people were aware that such a program existed, or would even know where to look for it.

Another example of such misdirection in policy is the provision of low-income relief to single people in general. As was noted earlier, the exemptions and zero bracket amounts do not protect many poor single persons from income taxation because of a fear that such relief would be lost on young people who are in fact dependent on their parents, and whose own income therefore understates their true standard of living. Under the current tax law, the low income relief and the grad-

uated tax rates can be used by parents who transfer wealth to their children during life to reduce the tax on the income that such wealth generates.

Many would not want to eliminate the extra exemption for the elderly because of its function of reducing the tax burden on the financially vulnerable moderate-income elderly, among other reasons. And we cannot eliminate the low tax rates in the first brackets for single persons just to prevent tax minimization by a few wealthy families. But we could make the additional exemption for the elderly and the graduated rates more target-efficient by simplifying the tax code, eliminating many of preferential legal provisions that provide selective relief to taxpayers of all income levels, and adopting a lower tax rate schedule.

For example, the additional \$1,000 exemption for the elderly reduces tax by \$110 for those in the lowest tax bracket, but by \$500 for those in the highest rate bracket (like the millionaires discussed above). A system that limited exemptions to reducing tax in a 14 percent bottom tax bracket would save all elderly persons \$140. This would reduce the overall cost of the extra exemption and target the revenue loss on those most in need. Likewise, a system that cut the spread of tax rates to a 14 to 30 percent range would substantially reduce the reward to taxpayers who now manage to transfer income from family members in the 50 percent bracket to others at the 11 percent rate.

A number of proposals for fundamental tax restructuring have surfaced recently from both Congressional Democrats and Republicans. The Administration has also expressed an interest, with a report from the Treasury due shortly after the November elections. It is worth remembering that such proposals would have a payoff in the tax treatment of the poor, by directing more relief where it is needed most.

Chairman RANGEL. Thank you very much.
Now, Director Greenstein?

STATEMENT OF ROBERT GREENSTEIN, DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

Mr. GREENSTEIN. Mr. Chairman, thank you for the opportunity of appearing here today.

I would like to cover a variety of things related to the area, but in the latter part of the testimony I particularly would like to share with you some analysis of what I think are some inadequacies of the Senate Finance Committee proposal dealing with the earned income tax credit that I thought might be useful to you.

Chairman RANGEL. Very good, and both statements will appear in their entirety in the record.

Mr. GREENSTEIN. As you know, in recent years the Federal tax threshold has dropped far below the poverty line. In 1983, the tax entry point for a family of four was nearly \$1,400 below the poverty line, and for a family of six, \$3,900 below the poverty line. By 1985, according to the Joint Committee on Taxation, a family of four will have to pay taxes if it is \$2,166 below the poverty line, and by 1986, the tax threshold for a family of four will fall \$2,500 below the poverty line.

I think it is important to note that the indexing of the personal exemption of the zero bracket amount that starts next year will not halt or even appreciably slow the precipitous decline in tax thresholds in relation to the poverty line since the earned income tax credit is not indexed. More and more families in poverty will continue to be pushed into taxpaying brackets.

I think it is also interesting to note the contrast between the late 1970's, the pre-Reagan administration period, and the last few years in this area. From 1975 through 1980, tax thresholds were set at an average of nearly \$1,000 above the poverty level. But from 1981 to 1984, they will average \$1,250 below the poverty level, and for 1981 to 1986, the average gap will be \$1,600.

As we discuss these issues today, working families of four with gross incomes as low as 83 percent of poverty have to pay income taxes, and by 1986, those as low as 78 percent of poverty for a family of four will have to pay taxes. For families larger than four, the situation is harsher and the thresholds are set at even lower percentages of the poverty line.

Of course, in addition to the thresholds falling below poverty, as you mentioned today, the tax burdens on people at or near the poverty line have gone up substantially. One of the principal purposes of the EITC is supposed to be to offset part of the payroll tax burdens of working poor families. Yet, in recent years payroll taxes have risen sharply without corresponding increases in the EITC. From 1978 to 1985, payroll taxes for families at the poverty level will roughly level. When the increases in both income taxes and payroll taxes on poverty level families are added together, the result, the degree of increase is very striking.

As the table on page 4 of the testimony here, which is based on the Joint Tax Committee data shows, tax burdens for single persons and for six-person families at the poverty level jumped 200 percent from 1978 to 1985 when we consider both payroll taxes and income taxes.

For a family of four at the poverty level, the increase in tax burdens from 1978 to 1985 was 333 percent, and for a family of three—most striking of all—the increase was an astonishing 1,800 percent, from \$35 to \$660. Expressed in terms of percentages of income, the income and payroll tax burdens of three-person households at the poverty level jumped from under 1 percent in 1975 to 6.6 percent this year, and to 7.6 percent next year; for families of four, from 4 to 10 percent.

But perhaps most important of all, to get away from all of these statistics and look at how the families themselves would feel it, the combined tax burden for poverty level families of four has jumped \$900 from 1978 to 1985; for families of six, the increased tax burden is about \$1,000.

Now, as you know, Mr. Chairman, to families at any income level, \$900 or \$1,000 is a considerable amount of money. To a family at the poverty line that is struggling to make ends meet, and possibly having difficulty getting enough food to get through the month and paying its rent and heating bills, \$1,000 is an extremely large amount to pay in increased taxes. There is simply no way these families can pay such large amounts without decreasing their already-low standards of living.

I think it is important to look at how this happened, and I think the brief discussion earlier with the Treasury Department was not very illuminating on that score. The roots of the striking rise in the tax burdens of this Nation's poorest working families lies squarely in the Economic Recovery and Tax Act of 1981. Up until 1981, a basic pattern had developed in tax legislation. Every few years Congress cut taxes to offset some or all of the effects of inflation, and in so doing, Congress generally raised the zero bracket amount or the personal exemption or both.

In addition, the 1975 and 1978 tax acts, Congress established and then enlarged the earned income tax credit to help shield poor

families from income taxes and to offset some of the impact of payroll taxes which were beginning to rise rapidly.

In 1981, however, this pattern ended. After a period of particularly high inflation, the Reagan administration presented a massive tax cutting package that contained large business tax breaks for corporations and affluent taxpayers but failed to make any adjustment whatsoever in the ZBA, the personal exemption, or the earned income tax credit. Congress essentially ratified this approach, and now we are seeing the results.

I was somewhat struck that Mr. McLure congratulated the administration in his testimony for lowering the inflation rate and said had we not done this, the burdens would have been even more on low-income families. The fact of the matter is that had the administration not acted, Congress probably would have continued the normal pattern of providing relief to low-income families each time it did a tax bill and not completely ignoring them while conferring all the benefits on the upper end.

Indeed, much is made of the fairness issue these days, and normally it involves contrasting tax cuts for the wealthy with budget cuts for the poor. Equally significant, however, is the contrast between the real tax hikes for the poor and the large tax cuts that have been conferred on those at the top of the income scale.

In saying this, I am not speaking only of the Kemp-Roth cuts. Another provision of the 1981 tax cut, for example, lowered the maximum tax rate on capital gains to 20 percent. Today, the combined marginal income and payroll tax rate on a family of four earning \$12,000 a year is actually higher than the tax rates that wealthy investors pay on profits from capital gains.

A number of other provisions of the 1981 act were also aimed at upper-income brackets and bely the claim that the 1981 act was proportional according to income, which is not an accurate statement for the act as a whole. The reduction in the top rate on unearned income from 70 to 50 percent benefitted only couples with incomes above \$85,000 a year. The reductions in the estate tax benefitted only the wealthiest 3 percent of all American families. The ill-conceived all-savers provisions benefitted only the top 20 percent of taxpayers, and the ACRS provisions which even after the mid-course corrections in TEFRA will still provide corporations with tax breaks of approximately one quarter trillion dollars over the course of the decade, conferred 80 percent of their benefits on the largest 2,000 corporations in America, the top one-tenth of 1 percent of all corporations.

At a time when the administration and the Congress found room for billions of dollars in tax cuts, tax breaks and new tax shelters in the 1981 act, and tax shelters in 1983 were up 53 percent over 1982, no room could be found to adjust the ZBA, the personal exemption or the EITC to prevent the real tax burdens of the working poor from going up. The inequity of this approach is profound.

I would also note that you mentioned earlier in a question that it was one thing if the approach was not equitable, but another in dealing with investment and savings rates. What is striking there, too, is that the savings rate is now about 20 or 25 percent lower than it was when the 1981 act was enacted. This personal savings rate is lower than at any point since the end of World War II. In

terms of the capital investment rate, the capital investment rate over the last 3 years, while it has grown as we are coming out of the recession, when you look at it over the whole Reagan period, the last quarter 1980 to last quarter of 1983, it has grown at an annual rate of real growth of less than 1 percent, far less than under the previous administration.

Those parts of the 1981 act have not produced the results that we were told they would produce.

In addition, I think it is very important to note that the working poor families whose tax burdens are rising quickly are in a number of cases the same families who have borne the brunt of the deep budget cuts of the past few years. Recall that the group that has been most heavily affected by the budget reductions is the same group that is hit by the rise in taxes, the working poor.

Several new studies shed light on the situation. You mentioned earlier this morning the CBO study done at the request of Senator Chiles. One set of figures from that study that has not gotten too much ink in the media but I think is particularly significant is that the CBO study shows that the combined effect of the budget and tax changes enacted during the administration has been to reduce the income and benefits of families below \$10,000 a year by \$23 billion during the 1983 to 1985 period.

At the same time, while families under \$10,000 lost \$23 billion, CBO shows that the incomes of the wealthiest 1.4 percent of all families, those over \$80,000, went up \$35 billion during the same period.

As you also know, the GAO study that came out recently showed major impacts on AFDC families who are affected by the AFDC cuts in 1981, working families again.

In fact, I would make one final comment in this area. As someone who has spent a large amount of time in the last 12 years working on issues related to Federal food assistance, I very much believe that some of the families now showing up at emergency food pantries springing up around the country are low-income working families who are paying more in Federal taxes than ever before, and at the same time do not have the resources to buy enough food for their families to last through the month.

Where do we go from here?

Clearly there are a number of ways to approach this issue, but for the short term, the most effective—given a limited amount of dollars—is clearly the strategy involving earned income tax credit. The EITC has been eroded to such a degree since it has first entered the Tax Code in 1975 that by next year the value of the EITC in constant dollars will be less than half of what it was in 1975, as the chart on page 8 and the table on the page that immediately follows that shows. The decline is even sharper when the real value of the EITC in 1985 is compared to its value in 1979. The comparison with 1979 is particularly relevant because that was the first year that the EITC expansion legislated in 1978 to help offset recently enacted increases in social security payroll taxes took effect.

Since then, we have enacted further increases in payroll taxes without adjusting the EITC. As a result, by next year, 60 percent of the real value that the EITC had in 1979 will have disappeared, despite the fact that the poverty population is considerably larger

than it was in 1979. The real value of the EITC will erode even further in coming years because unlike the tax brackets, it is not indexed; and if the indexing of tax brackets results in less frequent tax legislation, as some hope, then the EITC may increasingly disappear in future years as an important part of the Federal tax structure.

Now, to turn to the issue of the Senate Finance Committee proposal, the Finance Committee proposal raises the EITC from 10 to 10½ percent of the first \$5,000 in earnings and phases it out at \$11,000 rather than \$10,000. This is a major disappointment. The Finance Committee proposal is so marginal, Mr. Chairman, that it, one, fails to bring the phaseout point for the EITC up to the poverty line; two, fails to do anything significant to arrest or even slow down appreciatively the continuing precipitous drop of the tax entry point in relation to the poverty line; and three, and perhaps most striking, it is so limited that it fails to keep the value of the EITC from falling even below 1984 levels in future years when measured in constant dollars.

In 1985 and subsequent years, the poverty line for a family of four and all larger family sizes will exceed \$11,000. However, the EITC under the Senate Finance provision will be unavailable to anyone above \$11,000. The tax entry point, now \$1,830 below the poverty line for a family of four, would still drop, under the Finance Committee provision, to more than \$2,000 below the poverty line for a family of four in 1985, and would be about \$2,400 below the poverty line in 1986.

Of course, the soaring tax burdens of families with earnings right at the poverty line would, except for smaller families, be entirely unaffected since families at the poverty line would still fail to qualify for the EITC. And finally, the value of the EITC in constant dollars would continue to erode sharply.

I call your attention to the chart on page 10 which shows that the value of the EITC in constant dollars under the Finance Committee proposal would drop from \$1¼ billion in 1975 to about three-quarters of a billion in 1984, and would continue to drop year by year down to less than \$500 million by 1989.

Indeed, there is a real danger that if Congress enacts the Finance Committee provision, it may think it has provided one of the needed periodic adjustments to the EITC and then ignore it for another 3 or 4 years while the tax situation of poor families grows yet worse.

What is needed, therefore, in the short term is a significant enlargement of the Finance Committee provision, accompanied by a provision to index the EITC at the same time that the indexing of other features of the tax code takes place, starting next year.

While this would remedy only a small portion of the damage that has been done in recent years, at least it would help prevent the situation from deteriorating further.

In the longer term, broader tax reform is needed that includes as one of its central elements the elimination of income tax burdens for poverty families as well as a more meaningful EITC or some other mechanism to perform the task for which the EITC was originally intended, and to offset more of the steadily escalating payroll tax burden on poor working families.

I would conclude with one final point not in my prepared testimony. Since the issue of the census expert panel valuing noncash benefits came up, I would like to share some very real concerns that I have about that panel. Mr. Matsui raised the point about the issues that they also address taxes. Clearly, it does not make a whole lot of sense to say that something like food stamps should count as income because it is available and you can purchase with it and ignore the fact that money that is withheld for taxes is not available and you cannot purchase anything with it.

But I think there is a second issue that is equally important, and that is that if noncash benefits are to be counted as income, it is not valid to do so in measuring poverty without reexamining the poverty threshold itself, which is a threshold that was established based only on cash income and which would probably need some adjustment if noncash benefits are to be counted. I am concerned at the way this is being handled. When the recent census report came out, there was a line in the report that said census and OMB would convene a panel of experts to recommend methods for integrating the value of noncash benefits into the measure of poverty. What they are doing is actually something different than this.

And permit me to speculate that there is a political coloration here. Apparently what OMB has told Census to do is to have a narrowly based panel that only looks at valuing noncash benefits and pretends that this has nothing to do with poverty. Therefore, the issue of whether the poverty threshold needs to be reexamined is, under my understanding, off limits to such a panel. Later on, Dave Stockman takes the recommendations on how to value benefits, starts counting them, and completely ignores the issue of the tax threshold.

Chairman RANGEL. Let me interrupt you to tell you that this committee has shared the very same concerns with the Census Bureau as well as with Congressperson Hall, and that no matter what happens, it will be monitored, and we will be responding, not knowing that is going to come out. But it is a legitimate concern.

Mr. GREENSTEIN. Thank you for the opportunity to appear here, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF ROBERT GREENSTEIN, DIRECTOR, CENTER ON BUDGET AND POLICY
PRIORITIES

I am pleased to have this opportunity to testify today on the federal tax treatment of low income persons. I am Robert Greenstein, director of the Center on Budget and Policy Priorities, a non-profit research and analysis organization that focuses on federal policy issues affecting low and moderate income persons.

The Subcommittee is to be congratulated for holding this hearing. In the continuing debate over poverty and how federal budget policies have affected it, the issue of taxes has been given too little attention. The striking increases in the tax burdens of poor working families in recent years have lowered their living standards and pushed them deeper into poverty.

As the Subcommittee knows, the failure to increase the zero bracket amount, the personal exemption, or the earned income tax credit since the 1978 tax act—despite a period of rapid inflation—has substantially increased the taxes that the poorest working families (those at or below the poverty line) must pay. This has occurred at the same time that tax burdens for those at the upper end of the income scale have been lightened substantially.

The precipitous drop in the income tax threshold

In recent years, the federal tax threshold has dropped far below the poverty line, so that substantial numbers of those who live in poverty now have a portion of their small incomes eaten up by income taxes. In 1983, the tax entry point for a family of four was \$1,383 below the poverty line. For a family of six, the tax entry point was \$3,900 below the poverty line.

In 1984, the tax entry point for a family of four is \$1,830 below the poverty line, while a family of six will have to pay income taxes even if it is \$4,000 below the poverty line.

By 1985, according to the Joint Committee on Taxation, a family of four will have to pay taxes if it is \$2,166 below the poverty line. And by 1986, the tax threshold for a family of four will fall \$2,500 below the poverty line. The indexing of the personal exemption and the zero bracket amount that start next year will not halt the precipitous drop in tax thresholds in relation to the poverty line. Since the earned income tax credit is not indexed, more and more families in poverty will continue to be pushed into tax-paying brackets.

This tax treatment of low income working families is in sharp contrast with previous federal policies in this area. From 1975 through 1980, the tax thresholds were set an average of nearly \$1,000 above the poverty level. But during 1981-1984, tax thresholds will average \$1,250 below the poverty level, and for 1981-1986, the average gap will surpass \$1,600.

Indeed, as we discuss these issues today, working poor families of four with gross incomes as low as 83 percent of poverty are having income taxes, as well as social security taxes, withheld from their paychecks. By 1986, four person families at just 78 percent of poverty will be required to pay income taxes.

For larger families, the situation is harsher—the tax thresholds are set at even lower percentages of the poverty line.

The mushrooming tax burdens of poor families

Not only have the tax thresholds fallen well below the poverty line, but the tax burdens that poor families must pay have also increased. In 1978, the tax threshold fell below the poverty line only for single persons, and the maximum federal income tax they paid was \$16. Three and four person households at the poverty line paid no federal income tax in 1978, and the earned income tax credit offset a substantial share of their social security payroll taxes, as it was intended to.

Today, this has changed dramatically. As the following table illustrates, income taxes on persons at the poverty level have risen dramatically from 1978 to the present.

INCOME TAX AT THE POVERTY LEVEL

	Single person	Family of 4	Family of 6
1978.....	\$16	—\$134	0
1984.....	226	365	\$570
1985.....	237	383	599

This change is even more striking when payroll taxes are added in. Although one of the principal purposes of the earned income tax credit is supposed to be to offset part of the payroll tax burdens of working poor families, payroll taxes have risen sharply in recent years without compensatory increases in the Earned Income Tax Credit (EITC). From 1978 to 1985, payroll taxes for families at the poverty level will roughly double. When the increases in both income taxes and payroll taxes on poverty-level families are considered together, the result is nothing short of extraordinary.

COMBINED INCOME AND PAYROLL TAX AT POVERTY LEVEL

	1	4	6
1978.....	\$216	\$269	\$538
1984.....	579	1,076	1,523
1985.....	626	1,166	1,648

Source: Joint Committee on Taxation.

As the table shows, tax burdens for single persons and six-person families at the poverty level jumped about 200 percent from 1978 to 1985. For a family of four at the poverty line, the increase in tax burdens was 333 percent. And for a family of three, the increase in tax burdens from 1978 to 1985 was an astonishing 1,800 percent from \$35 to \$660.

Expressed in terms of percentages of income, the income and payroll tax burdens of three-person households at the poverty level jumped from 0.7 percent of income in 1975 to 6.6 percent of income this year and to 7.6 percent in 1985. For families of four, income and payroll taxes escalated from 4 percent of income to over 10 percent.

In dollar terms—perhaps the most important measure to the families, themselves—the combined tax burden for poverty-level families of four jumped \$900 from 1978 to 1985, while for poverty-level families of six, the increased tax bite exceeds \$1,000. To families at any income level, \$900 or \$1,000 is a lot of money. To a family at the poverty line that is struggling to make ends meet—and possibly having difficulty buying enough food to get through the month and paying its rent and heating bills—this is an extremely large amount to pay in increased taxes. There is no way these families can pay such large amounts without decreasing their already low standards of living.

How did this happen?

The roots of this striking rise in the tax burdens of the nation's poorest working families lie in the Economic Recovery and Tax Act of 1981 (ERTA). Up until 1981, a basic pattern had developed in tax legislation—every few years Congress cut taxes to offset some or all of the effects of inflation, and in doing so Congress would raise the zero bracket amount or the personal exemption, or both. In addition, in the 1974 and 1978 tax acts, Congress established and then enlarged the earned income tax credit to help shield poor families from income taxes and to offset some of the impact of payroll taxes, which were beginning to rise rapidly.

Yet in 1981, this pattern ended. After a period of particularly high inflation, the Administration presented a massive tax-cutting package that contained large business tax breaks for corporations and affluent taxpayers but failed to make any adjustment whatsoever in the Zero Bracket Amount (ZBA), the personal exemption, or the EITC. Congress essentially ratified this approach. Now we can see the results.

Much is made of the "fairness issue" these days, and it normally involves contrasting tax cuts for the wealthy with budget cuts for the poor. Equally significant, however, is the contrast between the real tax hikes for the poor and the large tax cuts that have been conferred on those at the top of the income scale.

In saying this, I am not speaking only of the Kemp-Roth rate cuts. One other provision of the 1981 tax cut, for example, lowered the maximum tax rate on capital gains to 20 percent. Today, the combined marginal income and payroll tax rate on a family of four earning \$12,000 a year is actually higher than the tax rates that wealthy investors pay on profits from capital gains.

A number of other provisions of the 1981 Act were also heavily aimed at upper income brackets. The reduction in the top rate on unearned income from 70 percent to 50 percent benefited only taxpayers with incomes above \$85,000 a year (for couples). The reductions in the estate tax benefited only the wealthiest 3 percent of American families. The ill-conceived All Saver provisions, benefited only the top 20 percent of taxpayers. And the ACRS provisions, which even after the mid-course corrections in TEFRA will still provide corporations with tax breaks of approximately \$250 billion over the course of the decade, conferred 80 percent of their benefits on the 2,000 largest corporations in America—the top 0.1 percent of all corporations. At a time when the Administration and the Congress found room for the billions of dollars in tax cuts, tax breaks and new tax shelters contained in the 1981 Act, no room could be found to adjust the ZBA, the personal exemption or the EITC to prevent the real tax burdens of the working poor from going up. The inequity in this approach is profound.

Moreover, these working poor families whose tax burdens are rising so fast are, in a number of cases, the same families who have borne the brunt of the deep budget cuts of the past few years. Recall that the group that has been most heavily affected by the budget reductions is the same group that has been most disadvantaged by the rise in tax burdens—the working poor.

Several new and important studies shed light on this situation. A new Congressional Budget Office (CBO) study released last week shows that even before the effects of inflation on tax burdens are taken into account, the combined effect of the budget and tax changes enacted during this Administration has been to reduce the

income and benefits of families below \$10,000 a year by \$23 billion during the 1983-1985 period. At the same time, the budget and tax changes have raised the incomes of the wealthiest 1.4 percent of families with incomes—those over \$80,000 a year—by \$35 billion, CBO found.

Equally striking are the new studies just issued by the General Accounting Office (GAO) and several universities and private research organizations on the effects of the 1981 AFDC cuts on low income working mothers and children. The GAO found that in the five cities where it conducted its study, low income working families terminated from AFDC lost an average of \$115 to \$229 a month (or \$1,380 to \$2,750 on an annualized basis) in income and benefits following the cuts. GAO also found that 30-60 percent of these families lacked health care coverage for their children after the AFDC cuts, that (in four of the five cities) one-half had run out of food at some point after being terminated from AFDC, and that 24-35 percent had their phone shut off. Yet at the very time that many of these working poor families were cut off AFDC and were experiencing hardships, their tax real burdens were being raised. It is most likely (and I say this as someone who has spend much of the past 12 years studying and working on issues relating to federal food assistance) that some of the families now showing up at emergency food pantries are low income working families who are paying more in federal taxes than ever before despite the fact that they do not have the resources to buy enough food to last through the month.

Where do we go from here?

The tax burdens of poverty families can be alleviated through adjustments in the zero bracket amount, the personal exemption, or the earned income tax credit. While raising the zero bracket amount deserves careful consideration at some point, the most effective strategy for the short-term—using a relatively limited amount of dollars—is to enlarge the earned income tax credit. I would therefore like to devote a little attention to the EITC before concluding this testimony.

The EITC has been eroded to such a degree since it first entered the tax code in 1975 that by next year, the value of the EITC in constant dollars will be less than half what it was in 1975.

EARNED INCOME TAX CREDIT

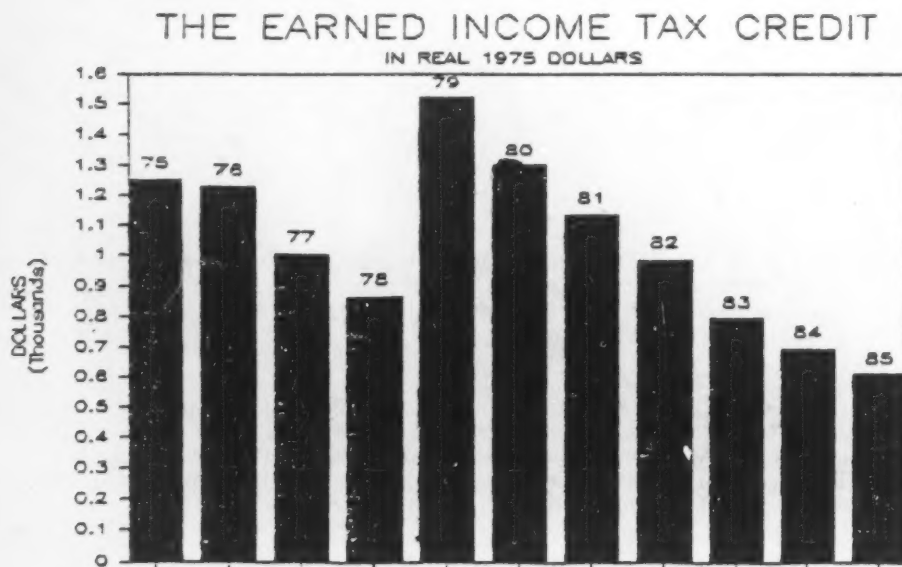
	Current dollars	Constant 1975 dollars
1975.....	1,250	1,250
1976.....	1,295	1,224
1977.....	1,127	1,001
1978.....	1,048	865
1979.....	1,052	1,522
1980.....	1,986	1,297
1981.....	1,912	1,131
1982.....	1,764	984
1983.....	1,466	792
1984.....	1,349	695
1985.....	1,254	615

The decline is even sharper when the real value of the EITC in 1985 is compared to its value in 1979. The comparison with 1979 is important because this was the first year that the EITC expansion, legislated in 1978 to help offset recently enacted increases in Social Security payroll taxes, took effect. Since then we have enacted further increases in payroll taxes, but without adjusting the EITC. By next year, 60 percent of the value the EITC had in 1979 will have disappeared, despite the fact that the poverty population is far larger than it was in 1979.

Moreover, the real value of the EITC will erode even further in coming years because, unlike the tax brackets, it is not indexed. And if the indexing of tax brackets results in less frequent tax legislation, as some hope, then the EITC may increasingly disappear in future years as an important part of the federal tax structure.

Table 1

This table shows the total value of the earned income tax credit in constant dollars.



The Senate Finance Committee proposal

This testimony would be incomplete without some discussion of the EITC provisions of the Senate Finance Committee tax bill now pending on the Senate floor. The Finance Committee provision, while better than nothing, is a major disappointment.

The Finance Committee proposal—which raises the EITC from 10 percent to 10.5 percent of the first \$5,000 in earnings and which phases out the EITC at \$11,000 rather than \$10,000—is so marginal that it:

Fails to bring the phase-out point for the EITC up to the poverty line;

Fails to do anything significant to arrest or even slow down appreciably the continuing precipitous drop of the tax entry point in relation to the poverty line;

Fails to keep the value of the EITC in future years (when measured in constant dollars) from falling below 1984 levels.

In 1985 and subsequent years, the poverty line for a family of four and for all larger family sizes will exceed \$11,000. However, the EITC, under the Senate Finance provision, would be unavailable to anyone above \$11,000.

In addition, the tax entry point—now \$1,830 below the poverty line for a family of four—would still be more than \$2,000 below the poverty line for a family of four in 1985 and \$2,400 below the poverty line in 1986.

The soaring tax burdens of families with earnings at the poverty line would (except for smaller families) be entirely unaffected, since families at the poverty line would still fail to qualify for the EITC.

Finally, the value of the EITC in constant dollars would continue to erode sharply, as the following chart shows.

THE EITC OVER TIME

	Current law		Senate Finance Committee	
	Current dollars	Constant dollars	Current dollars	Constant dollars
1975.....	1,250	1,250	1,250	1,250
1980.....	1,986	1,297	1,986	1,297
1981.....	1,912	1,131	1,912	1,131
1982.....	1,764	984	1,764	984
1983.....	1,466	792	1,466	792
1984.....	1,453	749	1,453	749
1985.....	1,324	649	1,332	653
1986.....	1,207	564	1,429	668
1987.....	1,103	493	1,308	584
1988.....	1,013	433	1,200	513
1989.....	988	405	1,161	476

Indeed, there is a danger that if Congress enacts the Finance Committee provision, it may think it has provided one of the needed periodic adjustments in the EITC—and then ignore the EITC for another three to four years while the tax situation of poor families grows yet worse.

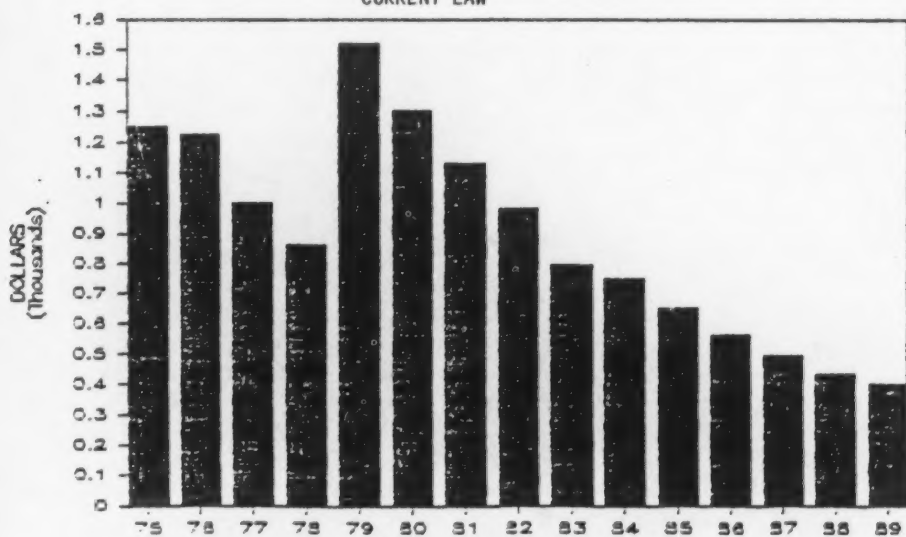
Needed remedies

What is needed in the short-term is a significant enlargement of the Finance Committee EITC provision, accompanied by a provision to index the EITC at the same time that the indexing of the other features of the tax code takes place. While this will remedy only a small portion of the damage that has been done in recent years, it will at least help prevent the situation from deteriorating further.

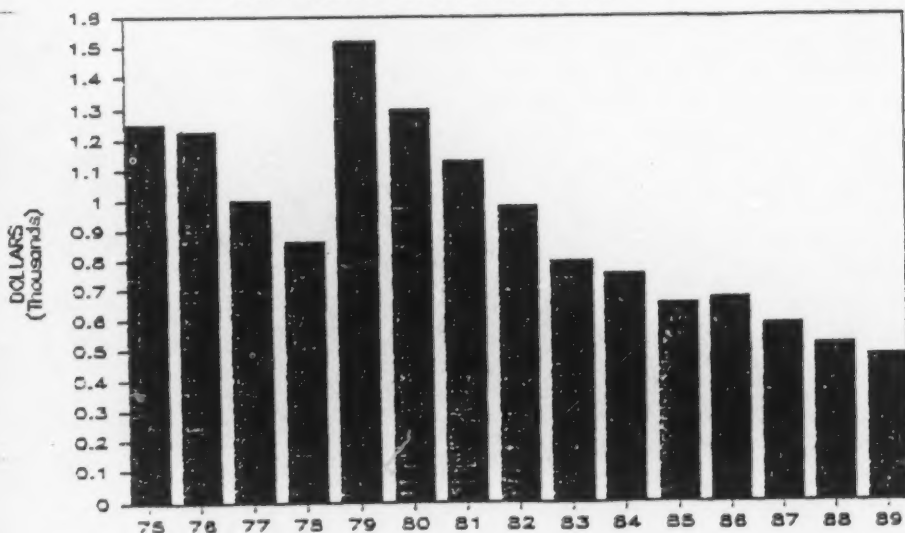
Table 2

The following two charts show the value of the earned income tax credit in constant dollars from 1987 through 1989, both under current law and under the Senate Finance Committee proposal to slightly increase the EITC. Data on EITC for 1985 through 1989 comes from the Office of Management and Budget.

EARNED INCOME TAX CREDIT 1975-1989 -- IN REAL 1975 DOLLARS
CURRENT LAW



EARNED INCOME TAX CREDIT 1975-1989 IN 1975 REAL DOLLARS
SENATE FINANCE COMMITTEE PROVISION



In the longer-term, broader tax reform is needed that includes as one of its central elements the elimination of income tax burdens for poverty families as well as a more meaningful EITC (or some other mechanism to perform the task for which the EITC was originally intended and to offset more of the steadily escalating payroll tax burden on poor working families).

Chairman RANGEL. Let me ask, have you taken into consideration the fact that for families receiving aid to dependent children assistance, the earned income tax credit is advanced and considered as income.

Have you looked to that?

Mr. GREENSTEIN. Clearly that is one more element that affects this. We do not have data other than the data that GAO recently presented you, or that the study by the Center of Social Policy, in conjunction with Columbia and Michigan provided, but in fact I think some of the earlier analyses that Tom Jobe did at the Center for Social Policy showed that with the counting of the EITC, the further reduction that that had on the real incomes of working poor families in regard to AFDC, and I certainly hope that the committee is able to hold firm in conference in regard to getting the center to agree to the provision that you have recently adopted in regard to counting the EITC for AFDC families.

Chairman RANGEL. I want to thank both of you for your excellent presentations and ask whether or not either center has concentrated on this specific issue prior to the preparation for these hearings.

Have you produced other documents in this area?

Mr. MINARIK. Not specifically on the question of taxation policies.

Mr. GREENSTEIN. We have produced one which I would be happy to share with the committee. This is a book, "Inequity and Decline: How the Reagan Tax Policies Are Affecting the American Taxpayer and the Economy," which came out a year ago at this time. It is not just on or primarily on low-income tax burdens. It covers the whole range of policies, but places emphasis on showing the skewed impact on different income groups.

Chairman RANGEL. We will be glad to have you share that with us, and as I said, I hope after the recess that you might be able to come back and work with us and the staff and see what we can expect to do in conference, but more importantly, what we can project as being at least the committee or the House position, and try to rectify the broadening gap.

Thank you very much, and if there are some things that you want to present, the record will be open for a reasonable time so you can send it in.

Mr. GREENSTEIN. Thank you.

Mr. MINARIK. Thank you.

[The following was subsequently received:]

COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC, April 17, 1984.

Dr. JOSEPH J. MINARIK,
Senior Research Associate,
The Urban Institute, Washington, DC.

DEAR DR. MINARIK: On behalf of the Subcommittee on Oversight, I wish to thank you for testifying on the federal tax treatment of low income individuals and fami-

lies. Your statement was important in aiding the Subcommittee's inquiry into the recent large increases in federal taxes on the poor. Your testimony was very informative; would you submit for the record Tables 1, 2 and 3, as computed in your testimony but including federal payroll taxes as well.

Again, I greatly appreciated your testimony.

Sincerely:

CHARLES B. RANGEL,
Chairman.

TABLE 1.—INCOME AND PAYROLL TAX BURDENS, HUSBAND-WIFE FAMILIES OF 4, SELECTED YEARS

	Income as a percent of poverty							
	80 percent	90 percent	100 percent	110 percent	120 percent	130 percent	140 percent	150 percent
1963:								
Income	0	0.82	2.54	3.94	5.11	6.10	6.95	7.69
Payroll	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.63
Total	3.63	4.45	6.17	7.57	8.74	9.73	10.58	11.32
1965:								
Income	0	0	.87	2.06	3.06	3.94	4.73	5.41
Payroll	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.63
Total	3.63	3.63	4.50	5.69	6.69	7.57	8.36	9.04
1975:								
Income	-8.33	-6.29	-4.66	-2.74	-.43	1.56	3.30	4.62
Payroll	5.85	5.85	5.85	5.85	5.85	5.85	5.85	5.85
Total	-2.48	-0.44	1.19	3.11	5.42	7.41	9.15	10.47
1981:								
Income	-6.20	-3.90	-0.86	1.62	3.77	4.71	5.53	6.36
Payroll	6.13	6.13	6.13	6.13	6.13	6.13	6.13	6.13
Total	-.07	2.23	5.27	7.75	9.90	10.84	11.66	12.49
1984:								
Income	-.97	1.75	3.38	4.16	4.98	5.68	6.27	6.79
Payroll	6.70	6.70	6.70	6.70	6.70	6.70	6.70	6.70
Total	5.73	8.45	10.08	10.86	11.68	12.38	12.97	13.49

SUPPLEMENT TO TESTIMONY OF JOSEPH J. MINARIK, SENIOR RESEARCH ASSOCIATE, THE URBAN INSTITUTE

This supplement presents some caveats and additional information regarding the testimony on federal tax policy and poverty.

THE POVERTY MEASURE

The official measure of the poverty threshold was instituted in the early 1960s. It was based on the cost of a nutritionally adequate diet, and increased for the share of the typical family budget devoted to the purchase of food. The poverty threshold was first measured for 1963, and has since been projected forward (and backward to 1959) according to the rate of change in the consumer price index (CPI).

Escalation of the poverty standard by the CPI means that it represents a constant amount of purchasing power over time. Of course, as real incomes increase, the poverty threshold falls behind the average incomes in the economy; so the poverty standard in 1963 was much closer to the average income of the population than it is now. The poverty standard might drift away from typical living standards in the economy over time for other reasons as well. The original poverty standards made no explicit allowance for taxes; because taxes have increased above the 1963 level in some years, the same poverty standard could represent less purchasing power for market goods.

Another issue is the ability of the CPI to represent accurately changes in prices over long periods of time. As consumer market baskets change dramatically, it is difficult to keep the CPI on track. One particular difficulty has been the handling of owner-occupied housing, and especially mortgage interest cost. Some economists would argue that the CPI overstated true inflation in the late 1970s and early 1980s. Though the handling of homeownership costs in the CPI has been revised, any excessive measured inflation from the earlier years remains permanently embedded in the CPI-measured price level.

There is certainly some arbitrariness in the poverty standard, but it would be a mistake to divert these hearings to a dispute over whether the poverty threshold does or does not measure precisely a subsistence level of income over each of the last twenty years. The poverty threshold series is certainly a nearly constant level of purchasing power, and it is a level that is modest by the standards of any time in the last two decades. If the tax burden on persons near that standard has increased, then there is a strong case that persons of limited means are bearing weightier burdens.

The particular poverty measures used in the tables in this testimony are based on the original poverty thresholds. These thresholds are differentiated according to the sex and age of the family head, the farm or non-farm residence occupied, and the composition of the family among adults and children. More recently, the Census Bureau has issued thresholds differentiated only according to the number and age of adults and children in the family, representing weighted averages of the population with respect to all of the other attributes. This means that the poverty thresholds change not only as the price level changes, but also as the composition of the population changes among male- and female-headed households, and farm and non-farm residences. For the purposes of this testimony, I believe that the original thresholds, showing the poverty line for a particular kind of household and changing only because of changes in real purchasing power, are more appropriate. Nonetheless, the conclusions should not be altered significantly whichever thresholds are used.

INCOME SOURCES

The hypothetical households in the tables are assumed to receive all of their income from labor. This may or may not be representative of actual households at the same income level. Many low-income households receive some income from public transfer programs, either cash or non-cash, which is not subject to taxation. Obviously, if some of a household's income is not subject to tax, it is better off. Other households with similar incomes are composed of elderly members; such households would receive some of their income as nontaxable Social Security benefits, but likely also some taxable interest or dividend income that does not qualify for the earned income credit. Thus, real-world households could be either better or worse off than the example households with similar incomes.

The most important point, however, is not to be too picky about the inevitable differences between example households and some households in the infinitely diverse real world. The point is that any real world family supported by a near-minimum-wage job would face the rising tax burdens described in the tables. This eventuality should be a consideration in the making of tax policy, even if some families with similar incomes would not be so taxed.

THE EARNED INCOME TAX CREDIT

The earned income tax credit (EITC) is an important factor in the tax outcomes described in the body of this testimony, and is also one of the least known and understood provisions of the tax code.

This very lack of awareness and understanding is a limitation on the effectiveness of the EITC. It can delay or possibly even prevent the delivery of low-income relief to taxpayers. Employers who are not aware of the existence of the credit, or who are unwilling or unable to deal with the complication, might not use the available procedures to deliver the credit to low-income workers as reductions in their withholding. Without this step, the worker must wait for his credit as an end-of-year tax refund, making it a less than fully effective vehicle for income security. If the taxpayer himself is unaware of or does not understand the credit, he might not claim it on his tax return, meaning that he must wait until the IRS discovers the omission. In some cases, people who deserve the credit might fall through the cracks and not receive it at all; this could be true of workers whose wages are so low that no tax is withheld, meaning that they would not need to file to claim a refund. There are still other drawbacks to the credit; it does not cover many needy persons who do not

have dependent children, and it adds to marginal tax rates in the income range over which it is phased out.

Nonetheless, the EITC performs the important function of shielding some low-income workers from a rising payroll tax burden. It may not be ideal income security or tax policy, but it stands alone in that particular role.

OTHER TAXES

This statement dealt with the effect of federal income taxes on the poor and near-poor. Of course, these people pay other taxes as well. Just how one views these tax burdens depends on broader issues regarding the concepts of poverty and long-term income security.

As was noted above, the official poverty standards do not explicitly account for any taxes. But they do implicitly account for some taxes. Because the original poverty thresholds are escalated from the base year of 1963 by the rate of increase of the CPI, and because the CPI measures prices including sales and excise taxes, the poverty thresholds in effect allow for the purchase of a constant 1963 market basket including sales and excise tax costs. Thus, if a particular observer is strictly concerned with the 1963 cost of subsistence, changes in sales and excise taxes after 1963 are of no consequence; the only possible issue is whether the 1963 poverty standards were high enough to bear the sales tax burden imposed at that time. If the perspective is somewhat different, and all sales and excise taxes are considered to be unfair burdens for anyone near the subsistence level, then changes in those taxes are relevant; but from that point of view, the poverty standard is mismeasured because it exceeds the net of tax costs of the 1963 subsistence market basket.

For the record, the Advisory Commission on Intergovernmental Relations reports 31 increases of state sales taxes over the 1981-83 period (counting each increase for several states that raised their sales taxes more than once), as opposed to 28 increases of state income taxes. The most recent data have not yet captured all of these legislative developments, but over the last several years state income tax revenues have increased faster than state sales tax revenues. This result is probably caused by inflation-induced "bracket creep" at the state level, while retail sales were held down by the sluggish economy.

A tax that can bear substantially on poor households, and that is not accounted for in any fashion by the poverty standards, is the Social Security payroll tax. Over the period covered in the tables in the body of this testimony, the employee's share of the payroll tax increased from 3.625 percent to 6.7 percent. The potential impact of this change is obviously large; the attached table shows the effect for families of four, assuming, as in the text, that all income comes from wages.

Exactly how one views this development depends on his perspective of the Social Security system as a whole. The payroll tax takes cash out of the pockets of the poor and near-poor today, and by definition such persons are near subsistence. But on the other hand, the Social Security taxes buy the right to future benefits, and those benefits are not only calculated to give low-wage workers a higher-than-average real rate of return, but they also buy a higher level of return than they did at the beginning of the period. So the Social Security tax can be either a favored form of saving or a current cash drain, depending on one's perspective; the choice may depend heavily on the exact calibration of the earned income tax credit.

Distribution of Tax Reduction Under 1964 Act ¹

<i>Gross income (thousands of dollars)</i>	<i>[Personal income taxes]</i>	<i>Changes as a percent of existing tax</i>
0 to 3.....		-39.0
3 to 5.....		-26.9
5 to 10.....		-20.6
10 to 20.....		-17.0
20 to 50.....		-15.5
50 to over.....		-13.2
Total.....		-19.4

¹ Excludes effect of capital gains provisions and repeal of the requirement to reduce the depreciation basis of new property by amount of investment credit.

Source: Joint Committee on Internal Revenue Taxation.

Distribution of 1984 Tax Reduction Under 1981 Act ¹

Expanded income class ²	(Personal income taxes)	Changes as a percent of existing tax
Under \$5,000		(³)
\$5,000 to \$10,000		27.1
\$10,000 to \$15,000		23.9
\$15,000 to \$20,000		24.5
\$20,000 to \$30,000		25.4
\$30,000 to \$50,000		26.3
\$50,000 to \$100,000		25.7
\$100,000 to \$200,000		22.4
Over \$200,000		20.9
Total		25.1

¹ Includes only rate reductions and deduction for two-earner couples.

² Expanded income equals adjusted gross income plus excluded capital gains and various tax preference items, less investment interest to the extent of investment interest to the extent of investment income.

³ Not meaningful because this income class does not have positive tax liability.

Source: Joint Committee on Taxation.

INCOME AND PAYROLL TAX BURDENS, HUSBAND-WIFE FAMILIES OF 4, 1983 AND 1984

	Income as a percent of poverty							
	80 percent	90 percent	100 percent	110 percent	120 percent	130 percent	140 percent	150 percent
1983:								
Income	0	0.82	2.54	3.94	5.11	6.10	6.95	7.69
Payroll	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.63
Total	3.63	4.45	6.17	7.57	8.74	9.73	10.58	11.32
1984:								
Income	.97	1.75	3.38	4.16	4.98	5.68	6.27	6.79
Payroll	6.70	6.70	6.70	6.70	6.70	6.70	6.70	6.70
Total	5.73	8.45	10.08	10.86	11.68	12.38	12.97	13.49

POVERTY AND TAX LIMITS

	2-parent family of 4	1-parent family of 3	Single person
1963:			
Poverty	\$3,104.00	\$2,450.00	\$1,651.00
Tax limit	2,666.67	2,000.00	666.67
1964:			
Poverty	3,144.62	2,482.06	1,672.61
Tax limit	3,000.00	2,300.00	900.00
1965:			
Poverty	3,198.78	2,524.81	1,701.41
Tax limit	3,000.00	2,300.00	900.00
1966:			
Poverty	3,290.17	2,596.95	1,750.02
Tax limit	3,000.00	2,300.00	900.00
1967:			
Poverty	3,384.95	2,671.76	1,800.44
Tax limit	3,000.00	2,300.00	900.00
1968:			
Poverty	3,527.12	2,783.97	1,876.05
Tax limit	3,000.00	2,300.00	900.00
1969:			
Poverty	3,716.68	2,933.59	1,976.88
Tax limit	3,000.00	2,300.00	900.00

POVERTY AND TAX LIMITS—Continued

	2-parent family of 4	1-parent family of 3	Single person
1970:			
Poverty.....	3,936.70	3,107.25	2,093.91
Tax limit	3,600.00	2,975.00	1,725.00
1971:			
Poverty.....	4,105.95	3,240.84	2,183.93
Tax limit	3,750.00	3,075.00	1,725.00
1972:			
Poverty.....	4,241.34	3,347.71	2,255.95
Tax limit	4,300.00	3,550.00	2,050.00
1973:			
Poverty.....	4,505.37	3,556.11	2,396.38
Tax limit	4,300.00	3,550.00	2,050.00
1974:			
Poverty.....	4,999.57	3,946.18	2,659.24
Tax limit	4,300.00	3,550.00	2,050.00
1975:			
Poverty.....	5,456.54	4,306.87	2,902.30
Tax limit	6,660.00	5,870.00	2,564.29
1976:			
Poverty.....	5,771.34	4,555.34	3,069.74
Tax limit	6,860.00	5,986.00	2,700.00
1977:			
Poverty.....	6,143.69	4,849.24	3,267.79
Tax limit	7,520.00	6,296.00	3,200.00
1978:			
Poverty.....	6,614.19	5,220.61	3,518.05
Tax limit	7,520.00	6,296.00	3,200.00
1979:			
Poverty.....	7,358.88	5,808.40	3,914.15
Tax limit	8,626.00	7,509.00	3,300.00
1980:			
Poverty.....	8,354.06	6,593.89	4,443.48
Tax limit	8,626.00	7,509.00	3,300.00
1981:			
Poverty.....	9,220.61	7,277.86	4,904.39
Tax limit	8,635.00	7,523.00	3,300.00
1982:			
Poverty.....	9,785.89	7,724.05	5,205.06
Tax limit	8,727.00	7,675.00	3,300.00
1983:			
Poverty.....	10,100.69	7,972.52	5,372.50
Tax limit	8,783.00	7,769.00	3,300.00
1984:			
Poverty.....	10,544.12	8,322.52	5,608.36
Tax limit	8,783.00	7,785.00	3,300.00

POVERTY LINES AND TAX AMOUNTS, FAMILIES OF 4

	Income as percent of poverty								
	80 percent	90 percent	100 percent	110 percent	120 percent	130 percent	140 percent	150 percent	
1963:									
Income.....	\$2,483.20	\$2,793.60	\$3,104.00	\$3,414.40	\$3,724.80	\$4,035.20	\$4,345.60	\$4,656.00	
Tax.....	0	22.85	78.72	134.59	190.46	246.34	302.21	358.08	
1965:									
Income.....	2,559.20	2,879.10	3,199.00	3,518.90	3,838.80	4,158.70	4,478.60	4,798.50	
Tax.....	0	0	27.86	72.65	117.43	163.81	211.79	259.78	
1975:									
Income.....	4,365.60	4,911.30	5,457.00	6,002.70	6,548.40	7,094.10	7,639.80	8,185.50	
Tax.....	(363.44)	(308.87)	(254.30)	(164.33)	(27.90)	110.47	252.35	378.54	
1980:									
Income.....	6,683.20	7,518.60	8,354.00	9,189.40	10,024.80	10,860.20	11,695.60	12,531.00	
Tax.....	(414.60)	(293.57)	(72.19)	149.19	377.97	511.63	647.21	797.58	
1984:									
Income.....	8,435.20	9,489.60	10,544.00	11,598.40	12,652.80	13,707.20	14,761.60	15,816.00	
Tax.....	(81.71)	166.08	356.29	482.82	630.41	778.03	925.65	1,073.27	

POVERTY LINES AND TAX AMOUNTS, FEMALE-HEADED FAMILIES OF 3

	Income as percent of poverty								
	80 percent	90 percent	100 percent	110 percent	120 percent	130 percent	140 percent	150 percent	
1963:									
Income.....	\$1,960.00	\$2,205.00	\$2,450.00	\$2,695.00	\$2,940.00	\$3,185.00	\$3,430.00	\$3,675.00	
Tax.....		36.90	81.00	125.10	169.20	213.30	257.40	301.50	
1965:									
Income.....	2,020.00	2,272.50	2,525.00	2,777.50	3,030.00	3,282.50	3,535.00	3,787.50	
Tax.....			31.50	66.85	102.20	137.55	177.60	218.00	
1975:									
Income.....	3,445.60	3,876.30	4,306.00	4,737.70	5,168.40	5,599.10	6,029.80	6,460.50	
Tax.....	(344.56)	(387.63)	(369.30)	(291.95)	(182.22)	(70.23)	45.34	165.94	

1980:	Income.....	5,275.20	5,934.60	6,594.00	7,253.40	7,912.80	8,572.20	9,231.60	9,891.00
	Tax.....	(500.00)	(411.16)	(244.59)	(69.85)	115.15	303.08	491.01	686.76
1984:	Income.....	6,658.40	7,490.70	8,323.00	9,155.30	9,987.60	10,819.90	11,652.20	21,484.50
	Tax.....	(268.28)	(71.78)	132.14	336.05	549.71	667.79	784.31	924.37

POVERTY LINES AND TAX AMOUNTS, SINGLES

		Income as percent of poverty									
		80 percent	90 percent	100 percent	110 percent	120 percent	130 percent	140 percent	150 percent		
1963:	Income.....	\$1,320.80	\$1,485.90	\$1,651.00	\$1,816.10	\$1,981.20	\$2,146.30	\$2,311.40	\$2,476.50		
	Tax.....	117.74	147.46	177.18	206.90	236.62	266.33	296.05	325.77		
1965:	Income.....	1,360.80	1,530.90	1,701.00	1,871.10	2,041.20	2,211.30	2,381.40	2,551.50		
	Tax.....	64.51	89.64	115.15	140.67	167.59	194.81	222.02	250.76		
1975:	Income.....	2,321.60	2,611.80	2,902.00	3,192.20	3,482.40	3,772.60	4,062.80	4,353.00		
	Tax.....		6.65	47.80	91.33	136.18	182.62	231.18	280.57		
1980:	Income.....	3,554.40	3,998.70	4,443.00	4,887.30	5,331.60	5,775.90	6,220.20	6,664.50		
	Tax.....	35.62	97.82	160.88	231.97	303.06	381.66	461.64	541.61		
1984:	Income.....	4,486.40	5,047.20	5,608.00	6,168.80	6,729.60	7,290.40	7,851.20	8,412.00		
	Tax.....	131.37	198.66	270.12	348.63	427.14	505.66	587.68	671.80		

Chairman RANGEL. I would like to thank the staff. This has been a very effective hearing, and we will stand adjourned subject to the call of the Chair.

[Whereupon, at 11:40 a.m., the hearing was adjourned.]

[Submission for the record follows:]

KATZ, McANDREWS, DURKEE, BALCH & LEFSTEIN, P.C.,
Rock Island, IL, April 10, 1984.

COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC

(Attention of John J. Salmon, Chief Counsel).

DEAR MR. SALMON: Recent articles in tax literature have indicated that written comments should be submitted for consideration by the subcommittee in hearings to be held in connection with a review of policy questions relating to taxation of persons with incomes at or below the poverty level. As a practicing tax lawyer, I am familiar with some of these problems.

One suggestion which I would appreciate your bringing to the attention of the subcommittee during the hearings is the idea that all carrybacks should be optional. There are several provisions in the tax law which make carrybacks of unused losses or credits compulsory before carrying them forward. This has an impact on persons with very low incomes because they often have unused carrybacks or unused losses, yet the amount of these unused losses and credits do not justify the expense of preparing carryback applications.

On the other hand, if carryback were optional, the carryforward could be easily used by offsetting the unused credits and losses against future income. This is especially true with persons who have their returns prepared by professional preparers utilizing computer generated forms because the carryforwards can be handled as a routine matter while carrybacks must be done by hand.

The optional procedure for carrybacks would also be advantageous to the government because a carryback requires a more immediate reduction of government revenue than a carryforward. Also, a carryback involves searching files for past returns in order to make the necessary adjustments.

As an example of a particular experience that I had in this regard, I prepared a return for a taxpayer who was self-employed, but whose business had a very small profit during the tax year in question. In that year the individual purchased \$150 of new equipment which created a \$15 investment credit. Because the income of the individual was so small, there was no tax against which to apply the credit. It simply was not practical to file a carryback application for \$15 and reopen the third previous taxable year as required. It should also be noted that the cost to the government of refunding \$15 on a carryback would also be greater than the amount involved. If the carryback had been optional, however, the unused credit of \$15 would have been carried forward automatically on our computer data base used to prepare personal returns, and that amount would have been subtracted from tax in a future year in which, hopefully, the individual would have had some tax liability.

In my opinion, making the carryback of unused losses and credits optional would lead to less administrative expense on the part of the government, more usefulness of the credits and losses to individual taxpayers, and a financial advantage to the government in delaying the application of the credits and losses to a future rather than a past year.

Please let me know if you would like any further information or examples concerning these views.

Very truly yours,

BRUCE L. BALCH.